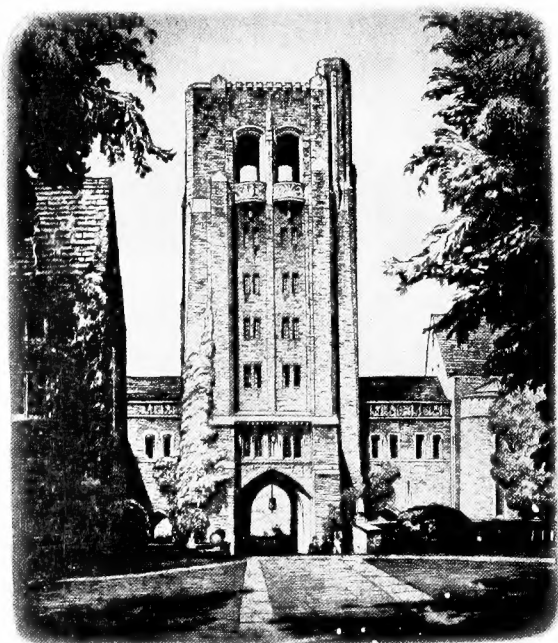




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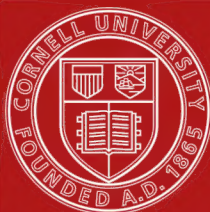
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A TREATISE

ON THE

LAW OF PRIVATE CORPORATIONS.

BY

HENRY O. TAYLOR,

OF THE NEW YORK BAR.

SECOND EDITION.

PHILADELPHIA :
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PREFACE TO THE SECOND EDITION.

THE text has been carefully examined for the present edition, and the cases have been brought down to date. While the writer has amplified the treatment of a few topics, he has tried to keep the book a text-book properly speaking, adapted for reading and study as well as for reference. He wishes to acknowledge the aid he has received in the preparation of this edition from his friend Robert H. Worthington and his brother Howard A. Taylor of the New York Bar.

HENRY O. TAYLOR.

NEW YORK, May 1, 1888.

PREFACE TO THE FIRST EDITION.

THE object of this Treatise is to give an accurate statement of the law regulating business enterprises which are prosecuted through the instrumentality of corporate organization; to define the rights and liabilities of the different classes of persons interested; and to treat of those rights and liabilities according to the manner in which they come before the courts for determination. To accomplish this the writer, having briefly noticed the views regarding corporations held in the Roman and in the older common law, submits in the third and fourth chapters an analysis of the notion of a corporation, with some remarks on the resemblances between corporations and certain other legal institutions. There follows, in the fifth and sixth chapters, a discussion of the rights and liabilities arising through the promotion and formation of a corporation. These chapters, which to a large extent are of an introductory character, are succeeded by a detailed discussion of corporate powers, and the legal effect of acts done by or on behalf of a corporation in occasioning legal relations between it and outsiders. The subsequent portion of the work treats of the rights and liabilities of the persons having interests in the corporate enterprise, treats, that is to say, of the legal relations subsisting with respect to it. These relations fall under three heads: First, those between the corporation on the one hand, and, on the other, the state, the shareholders, the officers, or the creditors of the corporation. Secondly, those between

PREFACE TO THE FIRST EDITION.

the different classes of persons interested,—between shareholders and officers, between shareholders and creditors, and between officers and creditors. Thirdly, those among persons of the same class ; that is, among shareholders, among officers, and among creditors.

It is the opinion of the writer that the fiction of the “legal person” has outlived its usefulness, and is no longer adequate for the purposes of an accurate treatment of the legal relations arising through the prosecution of a corporate enterprise. By dismissing this fiction a clearer view may be had of the actual human beings interested, whose rights may then be determined without unnecessary mystification. There will remain the body corporate; an organized body of men, exercising, directly or through agents, certain authority in a certain manner; there will remain the individual shareholders, the corporate officers and agents, the creditors of the corporation, and the public. To litigation arising from transactions respecting corporate interests there must be parties. The parties may be the corporation on the one hand, standing often as the representative of the rights of all persons in the corporate enterprise, and, on the other, some outsider or the state, or some shareholder, officer, or creditor; or the plaintiffs may be shareholders, the defendants officers, or the plaintiff a creditor, the defendant a shareholder. Suits may also be prosecuted in which names of shareholders or of creditors appear on both sides of the case. And the result of the suit will be affected by the position occupied by the parties towards the transaction occasioning the litigation.

In view of these considerations, the arrangement adopted in this treatise is thought suited to an accurate exposition of corporation law.

H. O. TAYLOR.

NEW YORK, May 1, 1884.

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LAW OF PRIVATE CORPORATIONS.

CHAPTER I.

THE NOTION OF A CORPORATION IN THE ROMAN LAW.¹

Early Roman view, § 1.	Varieties of Roman corporations, § 5.
A corporation not a person, § 2.	Illegal corporations. Dissolution, § 6.
Later Roman view, § 3.	Corporate capacities, § 7.
Special authority to form a corporation necessary only in later times, § 4.	Corporate management, § 8.
	<i>Hereditas jacens</i> , § 9.

§ 1. In the early periods of the Roman law, the idea of a corporation seems to have been that of a collection of individuals among whom, as well as between whom and outsiders, existed certain special legal relations.

Early Roman law.

If the notion of a corporate whole or unit was present at all, it existed in a rudimentary shape, and was of slight importance. The basis of this view lies in the names of many of the older and more prominent of the Roman corporations; names which were no other than the names of the members; as, for instance, *gentiles*, *virgines vestales*, *socii vectigalium publicorum*. The property, consequently, of these corporations was spoken of as if it belonged to the members, as *agri virginum vestalium*.² Later the term *universitas* became the generic name for corporations of all kinds,³ a term which seems to have conveyed in the main

¹ See Digest, iii. 4, *Quod cuiuscumque universitatis nomine vel contra eam agatur*; Digest, xlvii. 22, *De collegiis et corporibus*; Savigny, *System des heutigen Römischen Rechts*, vol. ii. §§ 85-102; Windscheid, *Lehrbuch des Pandektenrechts*, i. §§ 57-62;

Puchta, *Pandekten*, §§ 25-28; Arndts, *Pandekten*, §§ 41-47; Brinz, *Pandekten*, § 35 and §§ 59-63.

² See Ihering, *Gheist des Römischen Rechts*, iii. Theil, note 468 to p. 344.

³ The Rubric of Title 4, liber iii., of the Digest reads: "*Quod cuiuscum-*

the notion of a collection of individuals as opposed to the notion of a *singularis persona*, or one individual.¹

§ 2. Gaius, in his division of persons,² which was afterwards followed in the Digest of Justinian,³ never hints at corporations; and, indeed, the statement may be hazarded that in no place in the whole body of the Pandects are corporations said to be persons; though it is said that for certain purposes they are to be treated as such, *personæ vice fungitur*.⁴ It seems probable, moreover, that the law did not create this approach to a personification of corporations, but received it from the people, tolerating the fiction through deference to the popular view.⁵

§ 3. Nevertheless, though the Roman law never regarded a corporation as a person begotten of itself, and only said that for certain purposes the law would treat it as such, yet in the periods of the later and more fully developed law, a corporation was regarded as a something, as a corporate whole or unit, distinct from its members.⁶ To this corporate whole, and not to the individual members, attached the corporate rights and liabilities. "Si quid universitati debetur, singulis non debetur; nec quod debet universitas singuli debent."⁷ Consequently, the existence and identity of the

que *universitatis* nomine," etc. See Savigny, System, etc., ii. p. 261. The term seems not to have been in use much before the time of Cicero. *Corpus* and *collegium* were also used, the former more generally than the latter.

¹ See Dig., iv. 2, lex 9, § 1. Corporations sole did not exist at Rome. "Neratius Priscus tres facere existimat 'collegium' et hoc magis sequendum est." Dig., l. 16, lex 85. Still the scope of the applicability of this passage is not clear.

² Gai. i. 9 et seq.

³ Dig., i. 5, lex 3.

⁴ Dig., xlv. 1, lex 22.

⁵ "Juristische Personen heissen Personen nicht bloss deswegen weil sie Rechtssubjecte sind; sondern auch, weil

sie Personificationen sind; das Recht hat diese Personificationen nicht gemacht," Windscheid in Lectures. See Brinz, Pandekten, i. pp. 194-201.

⁶ See Savigny, System, ii. pp. 236-240.

⁷ Dig., iii. 4, lex 7, § 1. "Universitatis sunt, non singulorum, veluti quae in civitatibus sunt theatra et stadia et similia et si qua alia sunt communia civitatum." Dig., i. 8, lex 6, § 1. "Das Wesen aller Corporationen besteht darin, dass das Subject der Rechte nicht in der einzelnen Mitgliedern (selbst nicht in allen Mitgliedern zusammengenommen) besteht, sondern in dem idealen Ganzen," Savigny, System, ii. 144. "Eine Juristische Person ist eine nicht wirklich existirende, nur

corporation were not affected by the change of even all its members. "In decurionibus vel aliis universitatibus nihil refert, utrum omnes idem maneant an pars maneant vel omnes immutati sunt, sed si universitas ad unum redit, magis admittitur posse eum convenire et conveniri, cum jus omnium in unum recciderit et stet nomen universitatis."¹

§ 4. There is no reason to believe that any special authorization from the state was necessary in the early time in order to form a corporation. Under the empire, however, a special permission from the state became necessary;² and, by the pagan emperors, it was granted with great reluctance.³ The requiring of a special permission, as well as the reluctance of the emperors to grant it, seems to have been due to the evils arising from unauthorized and seditious societies.

Special authority to form a corporation necessary only in later times.

§ 5. The first corporations at Rome were formed for the regulation of trade and the purposes of religion.⁴ Under the republic municipal corporations come prominently into view, while the proportionate importance of religious corporations diminishes. The latter remained comparatively few in number until the conversion of the Empire to Christianity, to which event was due the abolition of the general rule, that a religious corporation could take property as *heres*, that is, through universal succession, only by

Varieties of Roman corporations.

vorgestellte Person, welche als subject von Rechten und Verbindlichkeiten behandelt wird." Windscheid, Pandekten, i. p. 147; see ib. p. 150. See, also, Sav., ii. 284-288; Dig., iii. 4, lex 1, § 1; Dig., i. 8, lex 6, § 1; Dig., xlviii. 18, lex 1, § 7; Dig., xl. 3, leges 1, 2, and 3; Dig., ii. 4, lex 10, § 4; Dig., vii. 1, lex 56. The statement in the text seems to be upheld by the great weight of authority; still Ihering, a distinguished jurist, says that the members were the true subjects of the corporate rights and liabilities according to the Roman law, and that the corporation itself was only the form which the mass of these rights and

liabilities assumed towards outsiders. This form, he thinks, was lost sight of in determining the legal relations of the members among themselves. Ihering, Gheist, etc., iii., Theil, pp. 219-220, 343-344. Another writer thinks the Roman law did not regard the property of a corporation as belonging to a person, but to a *universitas*, i. e., to no one; as *res nullius*. 1 Brinz, Pandekten, 196. See Gai. i. 9, and Dig., i. 8, lex 1 pr.

¹ Dig., iii. 4, lex 7, § 2.

² Dig., iii. 4, lex. 1 pr.

³ See Pliny, Epist. b. 10, letters 42, 43.

⁴ Sav. System, ii. p. 246.

virtue of a privilege specially conferred.¹ This rule had not prevented them, however, from receiving legacies or enjoying revenues through *fidei commissæ*, or trusts, created in their favor.²

§ 6. If the objects of incorporation were illegal, the corporation was liable to be dissolved by the state,³ which always had the power to dissolve corporations, even against the will of the members; though the members, without the consent of the state, could not bring about a dissolution⁴ any more than they could incorporate themselves. Moreover, a dissolution of the corporation was not effected by the death of all its members.⁵

§ 7. The right of a corporation to make by-laws for the regulation of its affairs appears to be as old as the Twelve Tables;⁶ and, not unlikely, the right to sue and be sued is equally ancient.⁷ A municipal corporation could have *possessio*, and, therefore, could acquire *proprietas* through *usucapio*.⁸ And a municipal corporation, moreover, through its constitutional representatives, could acquire

¹ The principles of the (pagan) Roman law on this point are expressed by Ulpian, xxii. § 6. "Deos heredes instituere non possumus, praeter eos quo Seto., constitutionibus Principum, instituere concessum est, sicuti Jovem Tarpejum." "Es war dem Christenthum vorbehalten," says Savigny, "die Menschenliebe an sich zu einem wichtigen Gegenstand der Thätigkeit zu erheben, und in dauernden, unabhängigen Anstalten gleichsam zu verkörpern." System, ii. 264. After Constantine *pia corpora* could take as *heres*, through universal succession. Sav., System, ii. 301, 308; and by a law of the Emperor Leo, A. D. 469, municipal corporations received the same privilege. See Codex, vi. lex 24, § 12.

² Dig., xxxviii. 3, lex 1; and Sav., System, ii. 305, and authorities there cited.

³ "Collegia si qua fuerint illicita . . . dissolvuntur. Sed permittitur iis, quum dissolvuntur pecunias communes si quas habent, dividere, pecuniamque inter se partiri." Dig., xlvii. 22, lex 3 pr. See Sav., System, ii. 257, note o.

⁴ Sav. System, ii. 280.

⁵ Sav. System, ii. 280.

⁶ "Gaius, libro quarto ad legem duodecem tabularum. Sodales sunt, qui eiusdem collegii sunt, quam Graeci *ἐταίρειαι* vocant. His autem potestatem facit lex pactionem quam velint sibi ferre dum ne quid ex publica lege corrumpant. Sed haec lex videtur ex lege Solonis translata esse." Dig., xlvii. 22, lex 4.

⁷ Dig., iii. 4, lex 7 pr. See Dig., iii. 4, lex 2.

⁸ Dig., xli. 2, lex 2.

rights and incur obligations. But, if its representatives borrowed money on its behalf, it was liable to repay only the part actually applied to its use.¹ Execution against the goods of a corporation took place in the same manner (by a *missio in possessionem*) as an execution against an individual.² Criminal law did not apply to corporations;³ neither could they be held liable in actions arising *ex delicto*, unless they had been enriched through the wrong.⁴

§ 8. As to the management of the affairs of corporations under the Roman law, very little is positively known; and the few passages in the Pandects relating to this topic seem applicable only to municipal corporations.⁵ Little more can be said than that probably, for the transaction of important business, the presence of two-thirds of the members was necessary to constitute a quorum; which number present, a majority vote was decisive.⁶

Corporate
manage-
ment.

§ 9. From the Roman rule that the *heres* succeeded to the legal personality of the deceased arose the peculiar conception of what many maintain to have been regarded by the Roman law as a legal person, *hereditas jacens*. This was the sum of the rights and liabilities of the deceased at the time of his death, regarded as subsisting by itself as a unit or a whole, until it should be determined who was to be the *heres*; "*hereditas personae vice fungitur, sicuti municipium et decurio et societas.*"⁷

"Hereditas
jacens."

¹ Dig., xii. 1, lex 27; see Sav. System, ii. 294.

² See Sav. System, ii. 297.

³ Sav. System, ii. 312.

⁴ Sav. System, ii. 317. "Sed an in municipes *de dolo* detur actio, dubitatur. Et puto ex suo quidem dolo non posse dari; quid enim municipes dolo facere possunt? sed si quid ad eos pervenit ex dolo eorum, qui res eorum administrant, puto dandam. De dolo autem decurionem in ipsos decuriones dabitur de dolo actio." Dig.,

iv. 3, lex 15, § 1. See Grotius, De Jure Belli, ii. xxi. 7.

⁵ It is possible that some of the passages already cited as applicable generally, were intended by the authors of them to refer to municipal corporations only.

⁶ See Sav. System, ii. 324 *et seq.* Dig., l. 9, leges 2 and 3; Codex, x. 31, lex 45; Dig., l. 1, lex 19; Dig., iii. 4, leges 3 and 4; Grotius, De Jure Belli, ii. v. 17.

⁷ Dig., xli. 1, lex 22; Dig., xli. 3, lex 15 pr. See Sav. System, ii. 365.

CHAPTER II.

THE NOTION OF A CORPORATION IN THE COMMON LAW.¹

Relation of the common to the Roman law, § 10.	Capacity to sue and use a seal, § 17.
Coke's idea of a corporation, §§ 11-13.	Capacity to hold lands, § 18.
Blackstone's idea of a corporation, §§ 14, 15.	Capacity to make by-laws, § 19.
Perpetual succession, § 16.	Dissolution, § 20.
	Doctrine that a corporation is a person, §§ 21, 22.

§ 10. THE early common law of corporations was largely borrowed from the Roman law.² In the Roman system, however, there are not to be found the fantastic structures of split hairs, with which the common lawyers, aided by the philosophers of the schools, delighted to adorn their system of jurisprudence. The "mysterious," "intangible," "invisible," "immortal," though "soulless" qualities of corporations are the creatures of the common law.

§ 11. In Coke on Littleton and Coke's Reports, the common law is embodied as in no other volumes. It is, therefore, in the main Coke's conception of a corporation which is given in this chapter, the modifications and developments of later authorities being briefly noted.

§ 12. "A body politic," says Coke, "is a body to take in succession, framed (as to that capacity) by policy, and therefore it is called by Littleton a body politic; and it is called a corporation or a body incorporate, because the persons are made into a body, and of a capacity to take and grant, etc."³

¹ See Case of Sutton's Hospital, 10 Rep. 1; Comyn's Digest, Title "Franchise;" Coke on Lit., Thomas' Ed., Book I. chap. xiii.; Viner's, Rolle's, and Bacon's Abridgments, Title "Corporation;" Kyd on Corporations, Introduction; Blackstone's Com., Book I. chap. xviii.; 2 Kent's Com., Lecture xxxiii.; Angell and Ames on Corporations, Introduction and chaps. i., ii., and iii.

² *E. g.*, the passage in Bracton, f. 7, concerning the ownership of public buildings is quoted from the Ins. of Justinian, ii. 1, § 6.

³ Co. Litt., 250 a.

“And it is to be known that every corporation, or incorporation, or body politic or incorporate, which are all one, either stands upon one sole person, as the king, bishop, parson, etc., or aggregate of many, as mayor, commonalty, dean, and chapter, etc., and these are in the civil law called *universitas sive collegium*. Now it is to be seen what things are of the essence of a corporation.¹ 1. Lawful authority of incorporation, and that may be by four means, sc. by the common law, as the king himself, etc., by authority of parliament; by the king’s charter;² and by prescription. The 2d, which is of the essence of the incorporation, are persons to be incorporated, and that in two manners, sc. persons natural, or bodies incorporate and political. 3. A name by which they are incorporated.³ 4. Of place, for without a place no incorporation can be made. 5. By words sufficient in law, but not restrained to any certain, legal, and prescript form of words.”⁴

“ When a corporation is duly created all other incidents are tacitly annexed. And for direct authority in this point in 22 E. 4, Grants, 30, it is held by Brian, chief justice, and Choke, that corporation is sufficient without the words to implead and be impleaded, etc., and therefore divers clauses subsequent in the charters are not of necessity, but only declaratory, and might well have been left out, as 1. By the same to have authority, ability, and capacity to purchase, but no clause is added that they may alien, etc., and it need not, for it is incident. 2. To sue and be sued, implead and be impleaded. 3. To have a seal, that is also declaratory, for when they are incorporated they may make or use what seal they will.⁵ 4. To restrain them from aliening or devising but in certain form;

¹ “To the essence of a body corporate two things are only requisite, sc. an incorporation and a gift, and not any words of fundare, exegire, and stabilere, or words to that effect.” Case of Sutton’s Hospital, 10 Rep. 28 a.

² Compare Franklin Bridge Co. v. Wood, 14 Ga. 80.

³ “A corporation is a body politic, consisting of material bodies, which, joined together, must have a name to

do things that concern their corporation, or otherwise there is no corporation.” Viner’s Abridgment, Tit. Corp. (A. 2.) 1.

⁴ Sutton’s Hosp., 10 Rep. 29 b.

⁵ “A corporation cannot do an act *in pais* without their common seal, yet they may do an act upon record.” Viner’s Ab’t, Tit. Corp. (G. 2.) 9; see Com. Dig. Franchise, F. 13, and 1 Kyd, 259–268.

that is an ordinance testifying the king's desire, but it is but a precept and does not bind in law. 5. That the survivors shall be a corporation, that is a good clause to oust doubts and questions which might arise, the number being certain. 6. If the revenues increase, that they shall be used to increase the number of the poor, etc., that is but explanatory. 7. To be visited by the governors, that is also explanatory. 8. To make ordinances; that is requisite for the good order and government of the poor, etc., but not to the essence of the incorporation.

. . . . 10. The license to purchase in mortmain is necessary for the maintenance and support of the poor, for without revenues they cannot live, and without a license in mortmain they cannot lawfully purchase revenues, and yet that is not of the essence of the corporation, for the corporation is perfect without it."¹

"And it is great reason that an hospital, etc., in expectancy or intendment, or nomination, should be sufficient to support the name of an incorporation, when the corporation itself is only in abstracto; for a corporation aggregate of many is invisible, immortal, and rests only in intendment and consideration of the law; and therefore in 39 H. 6, 13 b. 14, a dean and chapter cannot have predecessor nor successor, 21 E. 4, 27 (72) a, and 30 E. 3, 15. They cannot commit treason nor be outlawed nor excommunicate, for they have no souls,² neither can they appear in person, but by attorney. A corporation aggregate of many cannot do fealty, for an invisible body can neither be in person nor swear; and it is not subject to imbecilities, death of the body and divers other cases. A thing which is not *in esse* but apparent expectancy is regarded in law.³ So note, reader, a difference between an estate or interest, which none can take without present capacity, and a power, liberty or franchise, or thing newly created, which may take effect *in futuro*."⁴

¹ Ib. 30 b and 31 a.

² That corporations have no souls was clearly demonstrated before the days of railroads. "None can create souls but God; but the king creates corporations; therefore they have no

souls and this was the opinion of Manwood, chief baron, touching corporations." Tippling v. Pexall, 2 Buls. 233.

³ Sutton's Hosp., 10 Rep. 32 b.

⁴ Ib. 27 b.

§ 13. By implication, as well as by express words, could a corporation be created; for, "it is well observed, that in old times the inhabitants or burgesses of a town or borough were incorporated when the king granted to them to have *gildam mercatoriam*."¹

§ 14. A century and a half after the time of Coke, Blackstone speaks of the nature of corporations somewhat in detail. "As all personal rights," says he, "die with the persons, and as the necessary forms of investing a series of individuals, one after another, with the same identical rights, would be very inconvenient, if not impracticable, it has been found necessary, where it is, for the advantage of the public to have any particular rights kept on foot and confirmed, to constitute artificial persons who may maintain a perpetual succession, and enjoy a kind of legal immortality. These artificial persons are called bodies politic, bodies corporate (*corpora corporata*), or corporations."²

Blackstone's idea of a corporation.

Again, says Blackstone, "The name of the corporation is the very being of its constitution;" and, he continues, "the rights, capacities, and incapacities, which are necessarily and inseparably incident to every corporation, which incidents, as soon as a corporation is duly erected, are tacitly annexed of course are: (1) To have perpetual succession . . . and, therefore, all aggregate corporations have a power necessarily implied of electing members in the room of such as go off. (2) To sue and be sued, implead or be impleaded, grant or receive by its corporate name, and do all other acts as natural persons may. (3) To purchase lands and hold them for the benefit of themselves and their successors, which two are consequential to the former. (4) To have a common seal . . . (5) To make by-laws or private statutes for the better government of the

¹ Ib. 30 a. "By special words the king may make a limited corporation for a special purpose; as if the king grants *probis hominibus de Islington et successoribus suis* rendering a rent; this is a corporation to render the rent to the king, and not otherwise." Viner's Abt., Tit. Corp., G. 3; see, also, *Stebbins v. Jennings*, 10 Pick.

172, 188. "A corporation is good without limiting any number certain of persons to be of the corporation." Viner's Abt. Tit. Corp., F. 9. "And one corporation may be made out of another corporation." Sutton's Hosp., 10 Rep. 31 b; see *ib.* 33 b.

² 1 Bl. Com. 467.

corporation, which are binding on themselves, unless contrary to the law of the realm, and then they are void.”¹

§ 15. Blackstone’s statements are usually noteworthy for their perspicuity rather than their logic. Throughout his enumeration of the ordinary incidents of corporations, it is apparent, by his indiscriminate use of singular and plural pronouns, that he is not able wholly to make up his mind whether the capacities enumerated attach to the corporation as a unit, or to the members.

§ 16. As Coke says: “A body politic is a body to take in succession;”² so Blackstone regards the capacity of perpetual succession as the quality which, more than any other, constitutes the corporation what it is, and differentiates it from what it is not. “This is the very end of its incorporation,” says he, “for there cannot be a succession forever without an incorporation.”³ Mainly to this quality, then, is due the artificial personality of the corporation.⁴ But is it entirely clear how this quality is a quality of the corporation at all? for, as Coke himself says, “A dean and chapter cannot have a predecessor nor a successor.”⁵

Perpetual succession of whom? how? and to what? Apparently of the members, who, by fulfilling conditions prescribed by the charter, succeed to the rights and duties of former members, or acquire similar rights and incur similar duties. These rights and duties relate to the corporate property, purpose, and to the capacity of corporate action; in fact to the corporation.

¹ 1 Black. Com. 475, 476; Kent adds a sixth, the power of amotion or removal of members. 2 Kent, Com. 278.

² *Supra*, § 12.

³ 1 Bl. Com. 475.

⁴ “The distinguishing feature, far above all others, is the capacity conferred by which a perpetual succession of different persons shall be regarded in the law as one and the same body, and may at all times act in fulfilment of the objects of association as a single individual. In this way a legal exist-

ence, a body corporate, an artificial being, is constituted.” Nelson, C. J., in *Thomas v. Dakin*, 22 Wend. 71.

⁵ *Supra*, § 12. “Succession, however, is a property of the individuals, who exercise the corporate rights. They succeed each other. But to say that the corporation itself has perpetual succession, which is the expression in general use, and sufficiently accurate for general purposes, appears to be a solecism.” S. A. Foote, *arguendo*, in *Thomas v. Dakin*, 22 Wend. 32.

On the other hand, the corporation has certain rights, to which duties on the part of its members correspond. These duties are the objects of the rights of which the corporation is the subject or possessor. Towards outsiders, however, the corporation appears as the only subject of rights, outsiders taking no cognizance of the legal relations between the corporation and its members. Indeed, a common law corporation, as it appears towards the outside world, may be compared to the human body, which remains, as a whole, continuously the same, while the particles of matter composing it change from day to day. The outside world perceives no change in the particles; it does not even see them; and so can take no cognizance of their relations to the body as a whole. Accordingly, it would seem that in so far as a corporation is to be regarded as a person, or as a whole, distinct from the members, the attribute of perpetual succession denotes the quality of remaining the same while the succession of its members goes on. And the same what? as to its members, the same object of rights belonging to them, as well as the same subject of rights which have for their objects duties on the part of the members; as to the outside world, the same subject or object, as the case may be, of rights subsisting between outsiders and the corporation.¹

§ 17. The second and fourth of the ordinary incidents of corporations mentioned by Blackstone, the capacity to sue and be sued in the corporate name, and to use a corporate seal, are legal contrivances adapted, the one to facilitate the enforcing of corporate rights and liabilities, the other to facilitate corporate action. These two incidents may be thought out without conceiving the corporation to be a person, though by retaining this fiction one may dispense with looking deeper into the matter to discern who it really is that acquires rights and incurs liabilities through the use of the corporate seal, and who it is whose rights and liabilities are enforced by suits in the name of the corporation.

¹ These remarks are offered merely as an attempt to analyze the meaning attached by the common lawyers to the term "perpetual succession," a term which, as used by them, is not susceptible of clear analysis.

§ 18. The third of the ordinary incidents—the right to purchase and hold lands for the benefit of themselves and successors—is of importance. For this, as Coke says,¹ a special license in the charter is needed because of the statute of mortmain, but he adds that this right is not of the essence of the corporation, for the corporation is perfect without it.

§ 19. The last ordinary and inseparable incident mentioned by Blackstone is the power to make by-laws, “binding upon themselves, unless contrary to the law of the realm.” But Coke says that this right is not essential to a corporation,² and it is not even ordinarily incident to charitable corporations, whose by-laws are supposed to emanate from the founder.³ The right to make by-laws, moreover, is inconceivable as a capacity appertaining to the corporation as a unit, as an artificial person, and can be conceived only as a capacity of the members acting as a body.

§ 20. “When an integral part of a corporation is gone and the corporation has no power of restoring it, the corporation is so far dissolved that the crown may grant a new charter to a different set of men.”⁴ But, says Coke, “A corporation may be aggregate of many without a head, *vide* 18 E. 2.”⁵ By the death of all natural persons of which the corporation consists, it is dissolved;⁶ but it is not dissolved by a mere surrender of the charter.⁷

§ 21. It was a logical outcome of the notion of a corporation as a person, as a subject of rights and liabilities distinct from its members, that liability for corporate acts should be limited to corporate funds, and that upon the dissolution of a corporation all its rights and liabilities should become extinct.⁸

Doctrine that a corporation is a “person.”

¹ *Supra*, § 12.

² *Supra*, § 12.

³ See Angell and Ames on Corp., § 330, and authorities there cited.

⁴ *Rex v. Pasmore*, 3 T. R. 199; Bacon’s Abt., Tit. Corp. G. “If a corporation be made of confrères and sisters, and after all the sisters are dead, all grants and acts made by the

confrères are void; for when the sisters are dead this is not any perfect corporation.” Viner’s Abt., Tit. Corp. J. 1.

⁵ Case of Sutton’s Hospital, 10 Rep. 30 b.

⁶ Viner’s Abt., Tit. Corp. J. 14; see 2 Kyd, chap. 5, pp. 440 *et seq.*

⁷ Viner’s Abt., Tit. Corp. J. 26.

⁸ “The debts of a corporation, either

§ 22. The preceding is a mere attempt to outline the common law idea of a corporation. How a corporation came to be regarded as an artificial person seems plain. To see only this fiction of a legal person was easier than looking through it to discriminate and determine to whom the rights arising through incorporation really belong. Besides, up to the present century, the fiction was adequate for the regulation of corporate affairs; and what system of law ever looked ahead and saw that certain of its fictions were to be stumbling-blocks to unborn generations? The development of law is but a hand to mouth process.

to it or from it, are totally extinguished by its dissolution." 1 Bl. Com., 484. Compare the rule of the Roman law, § 6, note 3. One or two definitions of a corporation, which presumably proceed more or less from a common law point of view, may be of interest here. "A corporation, or a body politic, or body incorporate, is a collection of many individuals united in one body, under a special denomination, having perpetual succession under an artificial form, and vested by the policy of the law with the capacity of acting in several respects, as an individual, particularly of taking and granting property, of contracting obligations, and of suing and being sued; of enjoying privileges and immunities in common, and of exercising a variety of political rights, more or less extensive, according to the design of its institution, or the powers conferred upon it, either at the time of its creation, or at any subsequent period of its existence." 1 Kyd on Corp., 13 (1793 A. D.). "A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence. These are such as

are supposed best calculated to effect the object for which it was created. Among the most important are *immortality*, and if the expression may be allowed, *individuality*; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual. . . . It is chiefly for the purpose of clothing bodies of men in succession with these qualities and capacities that corporations were invented and are in use. By these means a perpetual succession of individuals are capable of acting for the promotion of the particular object like one immortal being." Marshall, C. J., in *Dartmouth College v. Woodward*, 4 Wheat. 636. Compare *Andrews v. Union Mut. Fire Ins. Co.*, 37 Me. 256; *Ohio Ins. Co. v. Munne-macher*, 15 Ind. 294. "A corporation is a franchise possessed by one or more individuals, who subsist as a body politic, under a special denomination, and are vested by the policy of the law with the capacity of perpetual succession, and of acting in several respects, however numerous the association may be, as a single individual." 2 Kent Com., 268. See, also, *Louisville R. R. Co. v. Letson*, 2 How. 497, 552; *Bank of U. S. v. Deveaux*, 5 Cr. 65, per Binney *arguendo*.

CHAPTER III.

ANALYSIS OF THE NOTION OF A CORPORATION.

The two meanings of the term "corporation," § 23.	Persons between whom exist the legal relations respecting the corporate enterprise, § 37.
Meaning of the terms "legal institution" and "legal relation," §§ 24-27.	Corporate management, § 38.
The constitution of a corporation. Incorporation, §§ 28-30.	Order of treatment, § 39.
Fundamental agreement between the corporators, § 31.	General nature of the legal relations existing in respect of the corporate enterprise, § 40.
The corporate funds, §§ 32, 33.	Trust relations, §§ 41-47.
Legal relations in respect of the corporate funds, §§ 34, 35.	The corporation also a body of men, §§ 48-50.
Result of the analysis, § 36.	Conclusion. The "legal person," § 51.

§ 23. IN "a corporation," according to the usual understanding of the term by business men as well as lawyers, exist elements which are the manifestations of law, and physical elements which are in no sense the manifestations of law; for a corporation is regarded as a legal institution, and at the same time as a collection of persons. Indeed, the indiscriminate use of the term "corporation" to denote what exists through the operation of rules of law, as well as to denote physical existences, has caused much confusion. The use of the term, however, to convey two meanings, or one twofold meaning, seems unavoidable in the present condition of legal terminology; but much of the confusion resulting from this equivocal use may be avoided by forming a clear idea of each meaning of the term, or an adequate notion of both sides of its twofold meaning.¹

¹ A few definitions will illustrate the two meanings of the term "corporation," and the confusion sometimes arising. Kent says (2 Com., 267), "a corporation is a franchise possessed by one or more individuals, who subsist as a body politic, under a special denomination, and are vested by

§ 24. Accordingly, let us in the first place regard a corporation as a legal institution. The term legal institution con-

the policy of the law with the capacity of perpetual succession, and of acting in several respects, however numerous the association may be, as a single individual." Blackstone (2 Com., 37) also calls a corporation a franchise.

On the other hand, Kyd (1 Kyd on Corps., 18) says: "A corporation, or a body politic or a body incorporate, is a collection of individuals, united in one body," etc. See, also, *Kansas Pacific R. R. Co. v. Atchison, T. & S. F. R. R. Co.*, 112 U. S. 415. Or, as Mr. Jay Gould has said, a corporation is "a body of men who unite, associate, concentrate their ability, capital, and intelligence in the undertaking of a work great or small, which any one of them individually would be unwilling to undertake. If there are losses, they agree to bear each his proportion. If there are profits, they agree to divide them."

The definitions of Kent and Blackstone convey the one meaning of the term "corporation," and Kyd's and Mr. Gould's the other. The two following definitions show how the two meanings may be confused.

"A corporation is a *body created by law, composed of individuals*, united under a common name, the members of which succeed each other, so that the body continues the same, notwithstanding the change of the individuals *who compose it*, and is for certain purposes considered as a natural person." Angell and Ames on Corps., § 1. It is plain that in so far as a corporation is a body created by law, it is not composed of individuals who are not created by law.

"A corporation is a *legal institution*

devised to confer upon the individuals of which it is composed powers, privileges, and immunities which *they* would not otherwise possess, the most important of which are continuous legal identity and perpetual or indefinite succession under the corporate name, notwithstanding successive changes, by death or otherwise, in the corporators or members of the corporation. It conveys, perhaps, as intelligible an idea as can be given by a brief definition, to say that a corporation is a legal person, with a special name, and composed of such members, and endowed with such powers, and such only as the law prescribes." 1 Dillon Munic. Corp., 25.

In having more than one meaning the term "partnership" resembles the term "corporation." For instance, Dixon (Law of Partnership, 1) says: "A partnership is a voluntary unincorporated association of two or more persons," etc.; while Kent (3 Com., 23) says: "Partnership is a contract of two or more persons," etc. Again the Indian Contract Act (§ 239) says: "Partnership is the relation which subsists between persons who have agreed," etc. Thus partnership is an association of individuals, is a contract, or a relation; and finally Rutherford (Inst. of Nat. Law, bk. 1, ch. 13, § 9) gives the following lucid definition: "When two or more persons join money, or goods, or labor, or all of these together, and agree to give each other a common claim upon such joint stock, this [?] is partnership."

On the other hand the term "suretyship" has but a single meaning, *i. e.*, the legal relations arising upon an

notes a body of legal rules in their manifestation in legal relations¹ between persons of whom certain correlated conditions of fact are predicable.² For instance, the rules of law which manifest themselves in legal relations when a person has agreed to answer for the debt, default, or miscarriage of another, constitute, in their manifestation, the legal institution of suretyship. The facts that one person has made a promise to another, which some third person has promised the promisee that the original promisor shall fulfil, constitute correlated conditions of fact which are predicable of the promisor, promisee, and surety, who are the persons between whom the legal relations subsist.

§ 25. It is through fulfilling conditions of fact by doing certain acts, that persons bring themselves within the operation of rules of law which thereupon manifest themselves in rights and liabilities. Every right implies a corresponding liability, and every liability a corresponding right; which is to say, a right with its corresponding liability constitutes a legal relation. Accordingly, when persons by their acts have brought themselves within the operation of a group of legal rules, and these rules have in their consequent operation manifested themselves in legal relations between such persons, the sum of these legal relations, *i. e.*, the manifestation of these rules in operation upon individuals, constitutes a legal institution.

§ 26. It is, therefore, little more than an identical proposition

agreement to answer for the debt, default, or miscarriage of another. It never means the individuals between whom these relations subsist.

¹ In the term "legal relation" the word "legal" is used in a broad sense, and not as opposed to "equitable."

² The writer has looked in vain for a definition of this term. His definition is but an attempt to determine a meaning in which he may use the term consistently. The mental process by which this definition was arrived at is somewhat as follows: A right is the power of an individual with the aid of the state to compel another to do or

refrain from doing something, and a liability means the liability of being obliged, by the state acting at the instance of the individual possessing the right, to do or refrain; though the term liability usually denotes a positive duty to do, rather than a negative duty to refrain. Every right implies a corresponding liability, and, together with this liability, constitutes a legal relation between two or more persons. See, also, § 442.

Rights and liabilities are called the creatures of law, but, in truth, they are rather manifestations of law than its creatures. Consider any ordinary

to say that rules of law¹ manifest themselves in legal relations only between persons of whom correlated conditions of fact are predicable. For instance, an enabling statute in connection with the general rules of corporation law, roughly speaking, may be said to constitute a group of legal rules which may manifest themselves in a legal institution consisting of legal relations, (a) among the persons who file the articles of association and subscribe for shares, and (b) between such persons and others who may afterwards deal with them as a body corporate in respect of the corporate enterprise. Here the agreeing to the articles and the filing of them are the conditions of fact which must be predicable of the incorporators before these legal relations can exist among them; and that other persons have had dealings with the incorporators in respect of the corporate enterprise are the further conditions of fact which must be predicable of the incorporators and such persons before legal relations between these two classes can exist.

§ 27. A corporation, then, is the manifestation of a body of rules of law in legal relations between persons who have fulfilled the prerequisite conditions of fact. But what rules of law? In general, those applicable to corporate enterprises, constituting

rule of law. "The lessee shall pay the lessor the rent agreed on in the lease." This general proposition, as stated here, is not accurate, for there is no absolute command from the state to lessees to pay rent (as there is a command from the state to all men to refrain from murder). The correct legal proposition is this: "At the instance of the lessor, the state will compel the lessee to pay the rent," which means that lessors *have the right* to compel lessees to pay the rent. This, then, is the general rule. Now where certain conditions of fact become predicable of A., that is, when A. becomes the lessor of certain premises, and when certain correlated conditions of fact become predicable of B., that is, when B. becomes the lessee of those

premises, a legal relation arises, to wit, a manifestation of law, *i. e.*, a concrete instance of law in operation, which may be expressed in the following proposition: "A. has the right to compel B. to pay the rent as agreed on in the lease." But there are other legal relations between A. and B. in respect of the demised premises, which further legal relations are the manifestations of other rules of law, and the sum total of all these legal relations, existing in respect to some definite subject-matter, is what the writer intends by the term legal institution as the manifestation of a group of legal rules in operation. See § 444.

¹ The writer leaves out of consideration rules of criminal law.

what is commonly called "corporation law," and, in especial, those contained in the enabling statute, or in the charter of the corporation, if there is one. For it will be borne in mind, that by filing articles of association in pursuance of statutory provisions, or by accepting a charter, persons bring themselves within the operation not only of the rules of law in the enabling statute or charter, but also of rules applicable generally to corporate enterprises, including many of the rules of the law of contracts and of agency.¹

§ 28. These more general rules of law, together with those contained in the enabling statute, or in the charter, if there is one, are embraced in what may be called the constitution² of the corporation; and the action of these rules (*i. e.*, the manifesting of themselves in legal relations), as caused by the corporators fulfilling the prerequisite conditions of fact (filing articles of association or accepting a charter), may be called incorporation, the result of which is a legal institution, to wit, a corporation.

§ 29. But the legal relations which arise immediately consequent upon incorporation are not its entire consequences. Incorporation has the further indirect result that future acts in respect of the corporate enterprise will give rise to legal relations different from those which such acts would have occasioned had there been no incorporation. Had there been no incorporation, the corporators might have proceeded to carry out the same business enterprise which they intend to prosecute after incorporation. They might have subscribed an amount of capital equal to the capital stock mentioned in the articles of association, and they might have done business on this capital, although not incorporated. But, doing business as an unincorporated firm, they would have incurred liabilities which,

¹ See *Relfe v. Rundle*, 103 U. S. 222.

² See *Relfe v. Rundle*, 103 U. S. 222. It will be noticed that the term "constitution of the corporation" conveys a notion similar to that conveyed by the term "corporation," meaning a legal institution. As was said, some pages back, "the term legal institu-

tion connotes a body of legal rules in their manifestation," etc. By the term constitution is intended the same body of rules, but considered as passive without regard to their manifestation in legal relations; without regard, that is, to whether individuals are within their operation or not.

through incorporation, they avoid. The legal relations arising in respect of their enterprise, for instance through contracts entered into in its prosecution, would have been the manifestation, not of corporation, but of partnership law.

§ 30. Incorporation, however, far from changing the legal effect of any and all acts which may be done by the persons who are corporators, changes the legal effect¹ only of acts done in respect of the corporate enterprise. The constitution of a corporation is operative only in relation to the purposes of incorporation and the means of their attainment. It is only as to these purposes, that the corporators, through incorporation, are enabled to act as an incorporated body; and it is only acts in relation to the corporate enterprise that occasion the rules of law embraced in the constitution of the corporation to operate upon the actors. Phrasing the whole matter somewhat differently, it may be said that the corporators by incorporation acquire the legal competency to employ certain funds or other property for the attainment of a certain object in a manner in which it would not have been legally competent for an unincorporated company to act.

§ 31. By far the most important of the acts which on the part of the corporators bring about incorporation, is the agreement, contained in the charter or articles of association, whereby the parties thereto agree that the legal relations constituting the corporation shall arise between them. This agreement is fulfilled through incorporation, which causes certain of the contemplated legal relations to arise, and provides for the coming into existence of further legal relations upon the doing of further acts in respect of the corporate enterprise. Upon incorporation this agreement receives the sanction of the rules of law in the constitution of the corporation, its terms becoming a part of the legal rules which manifest themselves in legal relations in respect of the corporate enterprise. Whether, and in what sense, the state may be regarded as a party to this agreement will be discussed in another chapter.² Here, it suffices to say, that the agree-

Funda-
mental
agreement
between
the corpo-
rators.

¹ Legal effect, *i. e.*, the legal relations which an act occasions.

² *Infra*, chap. viii., § 438 *et seq.*

ment thus embodied in the constitution of the corporation cannot be changed by the state unless the state reserves the power to change it; and this amounts to saying that the constitution of the corporation cannot be changed in any material respect by the state, unless the power to change it is reserved.¹ If this power is reserved, the agreement between the corporators, embodied in the constitution, must be regarded as made subject to the power of the state to alter the constitution and the agreement which it contains.

§ 32. The legal relations resulting from incorporation subsist in respect of the object of incorporation specified in the charter or articles of association and the means of attaining this object, *i. e.*, the corporate funds and property. Roughly speaking, the general result of these relations is that the corporate funds become a so-called trust fund set apart for the attainment of the object of incorporation, as will be explained.

§ 33. What is the legal situation of these funds? Can any one be said to own them? Austin says:² "The proprietor or owner is empowered to turn or apply the subject of his property or ownership to uses or purposes which are not absolutely unlimited, but which are incapable of exact circumscription with regard to class or number." And again, the owner "may not use his own so that he injure another, or so that he violate a duty, relative or absolute, to which he himself is subject. But he may turn or apply his own to every use or purpose which is not inconsistent with that general or vague restriction."

From the idea of ownership conveyed by these passages from Austin, it is plain that corporate funds cannot with propriety be said to be *owned* by any one;³ that is to say, the legal relations subsisting in respect of corporate funds are unlike those subsisting in respect of property which is *mine*. Using the term "corporation" in the sense of a legal institution, to say that the corporation owns the corporate funds is meaningless,

¹ Except in the exercise of certain powers which the state is held always to reserve, see §§ 465, 466.

² Lect. xlvii. on law as to its purposes and subjects.

³ "Strictly speaking, ownership is the right of a natural person or persons only." *State v. Bank of Louisiana*, 6 La. 745, 759; see also Angell and Ames on Corp., § 160.

for the legal relations in respect of the corporate funds are nothing but the major part of the legal relations composing the corporation; and consequently to make this assertion is to say that a mass of legal relations owns the major part of itself, which is nonsense. On the other hand, using the term corporation in the second sense before referred to,¹ as meaning a body of men, to assert that the corporation owns the corporate funds is to make not a meaningless, but an incorrect assertion. Even in law, it is best not to use terms in two senses. The term ownership connotes an indefinite multitude of rights in respect of the thing owned, including the right to destroy it. This multitude of rights is certainly not possessed by the incorporators either singly or as a body corporate; and, accordingly, with no propriety can they be said to own the corporate funds.

§ 34. The discussion of the legal relations in respect of the corporate funds, *i. e.*, the funds standing in the name of the corporation, will constitute a large part of this volume. The general outline is this: The state has the power or right to enforce the application of these funds to the objects of incorporation, at least so far as the public is interested in their attainment; the shareholders have the right to apply these funds to these objects; and the creditors of the corporation have the right to prevent the diversion of these funds from the objects of incorporation to the injury of creditors. The result of the respective rights of these different classes of persons is that corporate property becomes a fund set apart for the attainment of certain purposes from which it cannot be diverted without the consent of all whose legally protected interests would be injured by such diversion. It becomes a trust fund, a “Zweckvermögen,” as a German writer, Brinz, has aptly termed it.

Legal relations in respect of the corporate funds.

§ 35. Persons, not shareholders, bring themselves within the operation of the rules of law in the constitution of the corporation by contracting with the corporate representatives. The rights of such persons are the manifestations of these rules, which, in their operation, exclude the operation of other rules;

¹ See § 23.

as, for instance, rules whose operation would have been occasioned by contracting with the agent of an unincorporated firm.

§ 36. The result of the analysis reached at this point is briefly this: a corporation, considered as a legal institution, is the sum of the legal relations resulting from the operation of rules of law in its constitution upon the various persons, who, by fulfilling the prerequisite conditions, bring themselves within the operation of these rules. The general effect of these legal relations is to convert the corporate funds, in respect of which, through the operation of the constitution of the corporation, ownership properly speaking ceases, into a trust fund for the attainment of the objects of incorporation.

§ 37. It is needful here to state more specifically between whom these legal relations subsist. There is first the state, which is to be viewed in two characters: (a) as the political superior from whom emanate the rules of law which manifest themselves in legal relations in respect of the corporate enterprise; and (b) as a party between whom and others, through incorporation, arise legal relations of a peculiar nature protected by the constitution of the United States.¹ Secondly, there are the shareholders; thirdly, it will be convenient to regard the persons who ordinarily manage the corporate affairs—the directors and other officers—as a distinct class. Creditors constitute the remaining class of persons interested in the corporate enterprise. Their only interest is to be paid what is due them, and their only right is that the corporate funds shall not be wasted or misapplied so as to endanger the payment of their claims.

It will be necessary, moreover, to consider the legal relations subsisting between individuals of the same class; and, finally, there is still another and somewhat different view, which it will be convenient if not necessary to take of the legal relations in respect of the corporate enterprise. They must be regarded as subsisting between individuals of a class and the body cor-

¹ See chap. viii., § 438 *et seq.*

porate as representative of the interests of all persons in the corporate enterprise.

§ 38. The very notion of any organized body of men, or body-politic or corporate, implies the existence of certain rules for the management of the affairs of the body. Corporate management. The constitution of a corporation always contains rules for the management of the corporate enterprise; providing, as it does, that acts within the scope of the purposes of incorporation shall, if done by certain persons, have the same legal effect as if done or assented to by every one interested in the corporate enterprise. These certain persons are said to exercise the corporate powers. By filing articles of association, or accepting a charter, shareholders agree that the corporate enterprise shall be managed as provided for in the charter, or in the enabling statute and articles of association. Their individual right to manage the funds subscribed they surrender into the hands of a majority of themselves, and into the hands of the officers of the corporation, as provided for in the constitution. To the provisions in regard to the corporate management creditors impliedly assent in contracting with the corporation.

Thus, the body corporate, consisting of the shareholders as an organized body acting through the will of the majority and composing the corporation (regarded not as a legal institution, but as a body of men¹), is an agency with plenary authority to employ the corporate funds for the purposes of incorporation, and the acts of directors within the scope of their authority to act for the corporation are to be regarded as the acts of the body corporate. The remedy of persons aggrieved through the misapplication of corporate funds lies ordinarily against the body corporate; and the majority of questions litigated in court arise between some person or persons and the body corporate as representing all persons in any way interested in the corporate enterprise.

§ 39. In accordance with the foregoing remarks, the legal relations constituting the corporation will, in the chapters which follow the chapter on the legal effect Order of treatment.

¹ §§ 48-50.

of acts done on behalf of a corporation,¹ be treated in the following order: First, relations between the state and the body corporate as representing all persons interested in the corporate enterprise, and between the state and the different classes of these persons; secondly, the legal relations between the body corporate and these different classes of persons; thirdly, the legal relations between these different classes of persons; and, lastly, the legal relations among persons of the same class.

§ 40. Here a few remarks must be made on the general nature of these relations. They exist for the most part in respect of a certain fund, as to which various persons have rights. But not all of these various persons (the creditors, for example) have ordinarily a voice in the management of this fund; and consequently these different persons have not equal opportunity to protect their respective interests. Some of these persons, moreover, on account of rules which may exist in the constitution of the corporation, may be temporarily unable to enforce certain of their rights;² as, for instance, creditors may be temporarily disabled by the rule of general application that no creditor of the corporation can bring an action against the shareholders individually to enforce either unpaid subscriptions or statutory liability, until he has obtained judgment against the corporation, and execution thereunder has been returned unsatisfied. From these and other considerations, it would seem that many of the relations in respect of the corporate enterprise are what are loosely called "trust relations," a species of legal relation the essential peculiarities of which it would be well to determine before proceeding further.

§ 41. When one man owes a legal duty to another, which other actually or presumably is not in a position to enforce, at least for the time, the law imposes on the person owing the duty a stricter accountability to the person to whom the duty is owed than ordinarily exists between man and man. That is to say, the circumstances are such that

¹ Chap. vii.

temporarily in abeyance, or not yet

² Or we may say their rights are consummate.

rules of law apply to the two persons, which manifest themselves in peculiarly advantageous rights in the person under a disability. These are rights which, were it not for the circumstances causing the disability as a compensation for which they are given, the person under the disability would not have had. For instance, through inexperience and on account of other circumstances, an infant is presumed incapable of protecting itself against the acts of its guardian. Accordingly, not all the rules of law, applying ordinarily to transactions of sale, for instance, apply when the guardian purchases his ward's property; but certain other rules of law apply, which create further rights in the ward, and impose a most stringent accountability on the guardian, preventing the latter from taking advantages and profits to which he would have been entitled had the seller not been his ward.

§ 42. Accordingly, wherever there exists what is called a trust relation, there will be found an inability on the part of the *cestui que trust* to protect himself against the improper acts of the trustee; an inability arising either from the status of the former, as infancy or insanity, or from the special circumstances of the case. A client cannot adequately guard against the impositions of his attorney, nor an absent principal against the improper acts of his agent.

§ 43. Again, where a trust relation exists, there will usually be an actual confiding in the trustee by the *cestui que trust*, who intrusts his affairs to the former, or whose property may be confided to the trustee by others, as in testamentary guardianship. And the law will protect such confidence from abuse. The element of actual confidence does not exist when a person is held to the duties of a trustee by reason of his wrongful act, as the wrongful taking of another's property.

§ 44. A trust relation arises between directors and shareholders, because it is impracticable for the latter to keep themselves adequately informed of the state of the corporate business, and because they have put confidence in the directors. The directors are in a position to do the shareholders injuries, against which the latter can protect themselves only through the aid of the rules of law which manifest themselves in trust relations between these two classes of persons. Trust relations exist also

between the directors and the creditors of the corporation, on account of the inability of the creditors to protect their interests in the funds which the directors manage.

§ 45. Possibly it may also be said that shareholders, to the extent of their unpaid subscriptions to the capital stock, are affected with duties towards creditors, which constitute trust relations between them; for unpaid subscriptions, just as much as those paid in, are held to form part of the corporate funds, of the trust funds, to be devoted to the objects of incorporation; objects which include the payment of liabilities contracted in their pursuit. Yet this proposition is questionable, and there is a decision to the contrary.¹

§ 46. The reason last stated points to the third element often present when a trust relation exists, to wit, possession by one person of property of which another is the legal or equitable owner, or in respect of which the other has rights. This element occasions a trust relationship when one person has wrongfully taken the property of another; and the same element may be regarded as occasioning a trust relationship between bailor and bailee in respect of the property bailed; and thus a person may be held as trustee for another in certain respects, or in respect of certain property, while in other respects he owes the latter no special duty.

§ 47. In short, the circumstances ordinarily occasioning a trust relationship are: First, actual or presumptive inadequacy of the legal rules applicable to transactions of the same kind with the transaction occasioning the supposed relation, to bring about what the law regards as just or expedient; an inadequacy which may be due either to status or the peculiar circumstances of the case; secondly, confidence invited by one person, and by another actually reposed, in the discretion, honesty, and ability of the former; and thirdly, possession, rightful or wrongful, of property belonging to another, or in respect of which the other has rights.²

¹ *Morrison v. Savage*, 56 Md. 142. suitable, except for the roughest classi-

² It appears at a glance that the term trust relation is vague and un-

§ 48. Thus far a corporation has been regarded solely as a mass of legal relations. It is now necessary to determine who are the individuals composing the corporation regarded, not as a mass of legal relations, but as a body of men. Can it be said that the corporation, or body corporate, is composed of all the persons between whom these legal relations subsist? This conception would embrace all persons in any way interested in the corporate enterprise; it would embrace the state as representing the public, and, besides the shareholders and directors, it would also embrace the creditors of the corporation. No doubt this conception would be adequate; but, in the first place, it is repugnant to any popular or technical meaning of the term corporation; and, moreover, the conception of such an undefined body of men, if not hopelessly indefinite, would be at least too unwieldy for use.

The corporation also a body of men.

§ 49. On the whole, it is more in accordance with the ordinary use of terms, and a far clearer and more serviceable conception to regard the corporation as consisting of the shareholders, who may with propriety be said to constitute the body corporate, as it is through their acts, or the acts of their predecessors, that incorporation is caused. The management of the corporate enterprise is in their hands, or in the hands of persons chosen by them; and on them and their appointees the constitution confers the competency to do acts which occasion legal relations in respect of the corporate enterprise; in them and their appointees, that is to say, are vested the corporate powers.

§ 50. The shareholders, then, vested with the corporate powers, are the body corporate, corporation, or company. It is their acts, when done in the manner prescribed in the constitution of the corporation, that are, properly speaking, acts of the corporation. The main feature of their organization, as a body corporate, is that by virtue of their organization acts done in pursuance of its terms and within the scope of its purposes are in effect the acts of all; and, accordingly, such acts of a majority of a requisite quorum are to be regarded as the acts of the whole body.

§ 51. Such, then, are the two meanings of the term corporation; the one, the sum of legal relations subsisting in respect of

the corporate enterprise; the other, the organic body of shareholders whose acts cause the operation of the rules

Conclusion.
The "legal
person."

of law in the constitution. These two conceptions include all that is really connoted by the term in whatever sense used. And, if so, what has become of the venerable "legal person"? is he still somewhere, as he has always been imagined? or is he nowhere, as he has always actually been? Shall we regard him as being not only the sum of the legal relations in respect of the corporate enterprise, but, also, as being at the same time the body corporate consisting of shareholders? Shall we say, he is the combination, the mystic unification of our two conceptions? Better not; better forget him. For he is a conception, which, if it amounts to anything, is but a stumbling-block in the advance of corporation law towards the discrimination of the real rights of actual men and women. And then, after all, what has he ever been but an abstraction materialized in a name?¹

¹ How persons could succeed each other in the enjoyment of the same rights was a puzzle in the early law, to be solved only through regarding the successor as continuing in some way the legal personality of his predecessor. See the chapters on Succession in Mr. Holmes's interesting work "On the Common Law." The best known instance of the continuance of legal personality is the universal succession of the Roman law. But the early common law notions of succession resemble those of the Roman law more closely than is ordinarily supposed.

The fiction of a legal person was largely due to the difficulties of the early lawyers in respect of the succession of one person to the rights of another. Even to-day we help out our thought by saying that an assignee "stands in the shoes" of his assignor. However useful this fiction may once have been, it is to-day inadequate for the purpose of doing justice among

persons interested in corporate enterprises. And even where it can still be used, matters may be frequently simplified by avoiding it. Take, for instance, the following passage: "If a person becomes surety to several people for the conduct of a servant in their employ, and those people are afterwards incorporated, the surety is discharged; for the person created by the act of incorporation is different from the persons in whose employ the servant was, and with whom the surety contracted." 1 Lindley on Part., 214; see *Bensinger v. Wren*, 100 Pa. St. 500. In this passage a fiction is used to prove a legal proposition, the plain reasons of which lie on the surface. The contract of suretyship is strictly construed in favor of the surety. In the passage quoted, the liability of the corporators for acts of their servants, as well as their relations to the latter were changed by their own incorporation. Any such change discharges the

surety, who made a certain distinct contract, which was not a contract to guaranty the fidelity of a servant of an incorporated body of men.

It is in respect of the doctrine of *ultra vires*, that the fiction of a legal person is most pernicious, as this fiction involves regarding a corporation as a unit, and retards the proper discrimination of the rights of different persons in regard to *ultra vires* acts. Moreover, in the present condition of business enterprises in this country, this fiction may give rise to insolvable problems. For instance, a railroad company,

whose road extends through two states, is organized under charters from both ; each charter being the counterpart of the other. Is the result one or two "legal persons" ? Since as much may be said on one side as the other, the problem is as insolvable as it is gratuitous. The question of real importance is : What are the rights and liabilities arising under these charters in respect of the corporate enterprise ? And this question may be answered without reference to whether this railroad company is one or two "persons," or Siamese twins born of different mothers.

CHAPTER IV.

RESEMBLANCES BETWEEN CORPORATIONS AND CERTAIN
OTHER LEGAL INSTITUTIONS.

Object of the chapter, § 52.	Points of difference remaining, §§ 60, 61.
What law applicable to corporations, § 53.	The element common to these various legal institutions, § 62.
New York statute of 1875, §§ 54, 55.	Material questions, § 63.
New York joint-stock associations, § 56.	Law applicable to corporations how determinable, §§ 64, 65.
Comparison, § 57.	Changes in corporation law, § 66.
Limited partnerships, § 58.	The use of analogy, §§ 67-69.
Partnerships: dissimilar from corporations at common law, § 59.	The application of general principles, §§ 70, 71.

§ 52. THE object of this chapter is to point out some of the elements which corporations have in common with certain other legal institutions, and to determine somewhat more specifically than was attempted in the preceding chapter the rules of law which manifest themselves in the legal institutions called corporations. The danger of reasoning unguardedly as to questions of corporation law from the analogy of other legal institutions will be referred to incidentally.

§ 53. The common law notion of a partnership was sharply differentiated from the common law notion of a corporation. Nowadays it would not be easy to find a business corporation corresponding to the common law notion of a corporation. On the other hand, we find everywhere a great multitude of legal institutions, in great part the manifestations of statutory law, which resemble partnerships in some respects, while, in other respects, they resemble common law corporations. The law of these legal institutions, however, is not the law of partnership, nor is it altogether the common law of corporations. It is rather the statutory law

Object of
the chapter.

What law
applicable
to corpora-
tions.

under which they are organized, together with the later phases of the common law of corporations, construed and interpreted in accordance with the general rules of the law of contracts and of torts.

To notice here a few of the statutory provisions applying to some of these institutions will give point to the remarks which will follow.

§ 54. On June twenty-first, 1875, the legislature of New York passed "An act to provide for the organization of certain business corporations." Under this act, ^{The New York statute of 1875.} any five or more persons, a majority being residents of the state of New York, may file in the office of the secretary of state at Albany an application for a "certificate of incorporation." The application must set forth the intended name, object, and duration of the proposed corporation; as well as its intended place of business, and the amount with a description of its capital stock. Upon the filing of this application, the secretary of state is authorized to issue a license to those persons to open subscription books as commissioners; and when, in pursuance of the terms of this license, one-half of the proposed capital stock has been subscribed for, the commissioners may call a meeting of the subscribers to adopt by-laws and elect directors of the company. By-laws having been passed, directors elected, and a certified record of the proceedings filed with the secretary of state, "the secretary of state shall issue" a final certificate of incorporation. These companies have the ordinary "powers of corporations."

§ 55. Corporations created under this act are of two classes, "limited liability" companies, and "full liability" companies. In the former class, the shareholders remain severally liable to the creditors of the company, to the amount of stock held by them, for all debts of the company, until the whole amount of the capital stock has been paid in, and a certificate to that effect made and recorded. But no execution can issue against the "stockholders until an execution has been issued against the company, and returned unsatisfied." In the "full liability" companies, all the shareholders are "severally individually liable . . . for all debts and liabilities of such company, and may be joined as defendants in any action against the company ;"

though execution can issue against the stockholders only under the conditions prescribed in regard to the "limited liability" companies. In both classes of companies, contribution among shareholders in respect of their individual liability is provided for; and it is also provided that a dissolution of the company shall not impair any remedy given against such company, its shareholders, or officers for any liability incurred prior to its dissolution.

§ 56. A comparison of these "full liability" corporations with certain joint-stock companies, which are not called "corporations," will show the difficulty of using the term "corporation" in classifying legal institutions.

New York
"joint-
stock asso-
ciations."

Chapter 258 of the New York laws of 1849 provides:

(1) that any joint-stock company or association of seven or more shareholders or associates may sue and be sued in the name of the president or treasurer for the time being of such joint stock company or association; (2) that such suit shall not abate by reason of the death or removal of the president or treasurer; (3) that the president or treasurer shall not be personally liable for any such suit (though this provision is not to exempt him from any liability to which he is subject as a stockholder in the company); (4) that suits against the company shall be prosecuted in this manner in the first instance; but that, after judgment entered and return of execution thereon unsatisfied, suits may be brought against the stockholders individually. Chapter 245 of the laws of 1854 contains the following provisions: "1. Whenever, in pursuance of its articles of association, the property of any joint-stock association is represented by shares of stock, it shall be lawful for said association to provide by their articles of association that the death of any stockholder, or the assignment of his stock, shall not work a dissolution of the association, but it shall continue as before; nor shall such company be dissolved, except by judgment of a court for fraud in its management, or other good cause to such court shown, or in pursuance of its articles of association. 2. Said associations may, also, by said articles of association, provide that the shareholders may devolve upon any three or more of the partners the sole management of their business. 3. *This act shall in no court be construed to give said associations rights and privi-*

leges as corporations." Chapter 289 of the laws of 1867 provides that it shall be lawful for any joint-stock association to purchase, hold, and convey such real estate (1) as shall be necessary for its immediate accommodation in its business; (2) as shall be mortgaged to it in good faith; (3) as it shall purchase at sales under judgments, decrees, or mortgages held by it. "The said joint-stock company shall not purchase, hold, or convey real estate for any other purpose; and all conveyances of such real estate shall be made to the president of such joint-stock company, as such president, and who, and his successors, from time to time, may sell, assign, and convey the same, free from any claim thereon against any of the shareholders, or any person claiming under them."¹

§ 57. It thus appears, comparing the statutory provisions last quoted with those of the act of 1875 before referred to, that these joint-stock associations substantially resemble the "full liability" companies: yet the latter are called "corporations," while, as to the former, the legislature, in the same breath in which it gives them similar privileges and capacities, declares that in no court shall the statutory provisions regulating these associations "be construed to give them rights and privileges as corporations."²

§ 58. Limited partnerships afford another illustration of the difficulty of saying what constitutes a corporation. Such a partnership exists where one or more of the partners are liable individually for the firm debts, and one or more, provided the requirements of the statute are complied with, incur no personal liability for such debts beyond the amount contributed by them to the capital of the firm. Thus in limited partnerships exists a liability restricted to cer-

Comparison.

Limited partnerships.

¹ See also chap. 937 of laws of 1867, chap. 290, laws of 1868, and chap. 599, laws of 1881. The Massachusetts courts hold these New York joint-stock associations not to be corporations, and that their members may be sued as partners. *Boston & Albany R. R. Co. v. Pearson*, 128 Mass. 445.

See as to actions against them *Van Aernam v. Bleistein*, 102 N. Y. 355.

² It must be admitted that this provision dates from 1854, 20 years before the act of 1875 was passed. Still, both acts apparently stand together as part of the present statutory law of New York. See also *Braw v. Farwell*, 81 N. Y. 5.

tain funds, as is the case with most corporations. There are, moreover, *corporations* in respect of which there is no restricted liability; and so a limited partnership, which is not called a corporation, possesses an ordinary corporate attribute which some corporations lack.¹

¹ A limited partnership has been called a *quasi-corporation*; see Angell and Ames on Corp., § 45. In *Thomas v. Dakin*, 22 Wend. 9, 112 (1839), it was decided by the Supreme Court of the state of New York, whose chief justice at the time was the venerated Nelson, that certain banking institutions, formed under "an act to authorize the business of banking," passed April eighteenth, 1838, were corporations. The year following this decision, the case of *Warren v. Beers*, 23 Wend. 103, 196, was decided in the Court for the Correction of Errors in the same state. In this case, after the greatest deliberation, it was held that these same banking institutions were not corporations. The difficulty of saying, more than forty years ago, what constitutes a corporation is shown by the arguments and decisions in these two cases.

Likewise, in respect of public corporations, it is hard to say what constitutes them corporations. A city with a special charter has more extensive powers of a corporate action than a town, or a county, or "dock commissioners." In fact the last two are considered rather *quasi-corporations*!

Perhaps the following extracts will show what a *quasi-corporation* is. "There may be also private corporations created with powers *sub modo*, and for a few specified purposes only, and which are properly *quasi-corporations*. The joint-stock banks in England of modern creation, called into existence by the act of 7 Geo. IV.,

are considered *quasi-corporations*, as that act provides for a continuance of the partnership, notwithstanding a change of partners. In this case the partnership has the corporate attribute of succession. And a mining joint-stock association was deemed a *quasi-corporation*, because a suit for a demand against the company might, by virtue of an act of Parliament, be brought against the directors. Here is attached the corporate liability of *being sued* without the names of each individual partner composing the company." Angell and Ames on Corp., § 25, citing *Harrison v. Simmins*, 4 M. & W. 510.

Again, it is said in the same work at § 40: "A trading association may be but a mere partnership; or it may have corporate powers to a small extent and *sub modo*; or it may be invested with corporate functions to a considerable and yet limited extent; or it may exist with all the incidental functions and peculiar privileges which a grant of unconditional [?] corporate power confers." It would be hard to conceive of anything more conditional than a grant of the most "unconditional" corporate power. See also 2 Kent, Com., 274.

Of course, in all these cases of "*quasi-corporations*," whether public or private, the real questions are what joint or corporate action can be taken? and what are the legal relations arising? See *Liverpool Ins. Co. v. Massachusetts*, 10 Wall. 566.

§ 59. Baron Lindley, in his work on Partnership, quotes many definitions of that term, but prudently refrains from giving one himself, remarking pertinently, that "to frame a definition of any legal term which shall be both positively and negatively accurate, is possible only to those who, having legislative authority, can adapt the law to their own definition."¹ Still, every one has an idea of an ordinary business partnership; and an ordinary partnership differs from a corporation at common law chiefly in the following points: first, it is not an artificial person; secondly, a change of partners dissolves the firm; thirdly, the partners are personally liable for all the firm debts; fourthly, they are each other's agents in respect of the firm business; and, fifthly, a partnership requires no special sanction for its existence.

Partnerships: dissimilar from corporations at common law.

§ 60. Not all of these points of difference remain to-day. It is no longer clear that a corporation is a distinct person; and as to the third of these points it may be said, that in many corporations the members are personally liable, and that in some (limited) partnerships, not all the partners are personally liable. Moreover, under the general enabling statutes, the importance of the "special sanction" has passed away, and a corporation usually requires no more special sanction than a limited partnership. No legal institution exists save through the sanction or operation of the rules of law of which it is a manifestation.

Points of difference remaining.

§ 61. The differences which still exist, however, between a corporation and a partnership, make the application to the one of rules of law regulating the other likely to lead to error. Two points of radical difference remaining to-day are these: (1) In a partnership, each partner is the agent of the other partners in respect of the partnership business, while this is not true of shareholders in a corporation. (2) The members of a corporation may transfer their shares at will, and thereby, with certain exceptions, relieve themselves from all liability in regard to the corporate enterprise, the transferee of the shares succeeding to all the rights and liabilities of the transferrer. But a

¹ 1 Lindley on Part., p. 1.

partner cannot thus relieve himself from his liability, and a transfer of his interest ordinarily necessitates a winding up of the partnership business.¹

§ 62. In one respect, all these various institutions resemble each other, though not very closely. In connection with all of them are certain funds and property constituting a trust fund to be devoted in a certain manner to the accomplishment of certain objects. In the idea of a trust fund there are many gradations; but the essential quality running through them all is that which, viewed negatively, consists in the absence of complete ownership with the power of arbitrary disposal in any person; or, viewed positively, consists in this, that certain persons, other than the possessor or apparent owner, have rights in regard to the fund. These rights differ greatly, being of more importance in respect of a limited partnership,² or a corporation, than in respect of an ordinary partnership, or an unincorporated joint-stock association of unlimited liability.

¹ In many respects, an unincorporated joint-stock association resembles an ordinary partnership. "The fundamental distinction between partnerships and unincorporated companies is, that a partnership consists of a few individuals known to each other, bound together by ties of friendship and mutual confidence, and who, therefore, are not at liberty without the consent of all to retire from the firm, and substitute other persons in their place; whilst a company consists of a larger number of individuals, not necessarily acquainted with each other at all, so that it is a matter of comparative indifference whether changes amongst them are effected or not. . . . Indeed it may be said that the law of unincorporated companies is composed of little else than the law of partnership modified and adapted to the needs of a large

and fluctuating number of members."

¹ Lindley on Part., 5. See, generally, for distinctions between partnerships, joint-stock associations, and corporations, the introductory chapter to Lindley on Part.

"Commercial men and accountants are apt to look upon a firm in the light in which lawyers look upon a corporation, i. e., as a body distinct from the members composing it, and having rights and obligations distinct from those of its members. . . . But this is not the legal notion of a firm; . . . speaking generally, the firm, as such, has no legal recognition. This non-recognition of the firm, in the mercantile sense of the word, is one of the most marked differences between partnerships and incorporated companies."

¹ Lindley, *ib.* 206-207.

² *Innes v. Lansing*, 7 Paige, 583.

§ 63. In all instances, the material questions nowadays arising in connection with any of the legal institutions mentioned will be: What are the means and capacities of corporate action? and what are the rights and liabilities arising among the persons interested? These are the real questions of vital importance, the decision of which will not ordinarily depend on whether or not a given institution is to be called a corporation, which indeed is little more than a question of how far a mediæval nomenclature is applicable to modern institutions.

Material questions.

§ 64. Such being the resemblances between corporations, joint-stock associations, and partnerships; and the designation of the class to which any given institution belongs being so difficult, as well as barren of results when accomplished, how may the rules of law which manifest themselves in the mass of legal relations constituting a corporation be determined? These rules, as stated in the preceding chapter, are contained in the constitution of the corporation. Some of them, and the legal relations in which they manifest themselves, may be readily determined, as they are embraced in the enabling statute, or in the special charter, should there be one. Complementary to the rules of law in the enabling statute, exist, as constituent elements of the corporate constitution, the rules of law embraced in what may roughly be called corporation law, a term which connotes the mass of legal rules which have come into existence through the requirements of society with respect to joint action for a common object. A corporation, like any other legal institution, corresponds to a certain need of society; and the rules of law, manifesting themselves in it, are those which this need has called forth. These rules cannot always be reasoned out, or, in logical sequence, deduced from one another, because they do not compose a logically consistent whole; neither do they always appear reasonable in relation to the needs of society to-day. There is no reason to believe, however, that these apparently illogical rules were not, in their inception, logical and consistent with the mass of other rules of law then manifesting themselves in the institution in question. Many legal institutions of ancient origin, whose growth is ob-

Law applicable to corporations, how determinable.

secured through lapse of time, can no longer be analyzed into their constituent elements; nor can the process through which was attained the known resultant of their combined factors be traced historically or reasoned out from general principles. This process cannot, as it were, be reasoned out backwards, because many of the rules manifesting themselves in these institutions, at least in their application to these particular institutions, are of historical origin and technical. To say that a legal rule is of historical origin and therefore not reducible to logical principles, means that it is the resultant of a combination of different maxims of diverse origin, each of which in its own origin was perhaps logical and consequent enough, but appears in the present combination quite anomalous because of the obliteration of some step in the process of combination. Again, to say a rule is technical and not logical, is saying in most instances substantially the same thing, that it is an old rule, which at its origin was the outgrowth of other rules, in connection with which it was likely logical; that now these other rules are forgotten, and the "technical" rule remains a sort of logical anachronism, which is as impracticable to fit in with the present system of law, as to use the flint of an old "Queen Anne" in a modern "Winchester."

§ 65. Consequently, the constitution of a corporation, to which we must turn for the answer of legal questions arising in respect of the corporate enterprise, far from being so logical and consistent that some of its elements being known, the rest may be inferred with the unerring certainty with which the structure of a fossil bird may be inferred from its footprints; far from being a logical and consistent whole, the constitution of a corporation is a conglomerate of rules the union of which was due not to chance, for there is no chance; but to causes and occasions of which we may be ignorant.

§ 66. In the course of time, some of the rules of corporation law, their adaptability to the needs of corporate enterprises ceasing, have been silently dropped by the courts, or abolished by legislation. The new rules needed in their place have been either patently created by the legislature in the shape of statutes, or formed through a more obscure and intangible process. When not enacted by the

Changes in
corporation
law.

legislature, new rules which come into being seem to be formed by the courts reasoning them out in two methods; first by analogy, and, secondly, by applying general principles of law and common sense to the case in question.

§ 67. When to the solution of a question of law arising in respect of some legal institution, as, for instance, a corporation, a rule of law applicable to some other kind of legal institution, as, for instance, partnership, is applied by reason of the analogy between a corporation and a partnership, what has been done is this. The use of analogy. A rule, for the application of which to one legal institution there are probably sound reasons, has, because of some resemblance between this and another legal institution, been applied to the latter, in respect of which the reasons for the application of the rule may fail, for not unlikely the two institutions resemble each other in points which the rule in question does not touch. The application, then, of the rule to the latter institution having been caused by a misleading analogy, will likely be found unwise, and in this application the substantial reasons, which are the roots of any rule of law, failing, the rule itself will shortly like dead wood drop away.

§ 68. Analogies between legal relations constituting corporations and legal relations constituting partnerships may be at times advantageously, if guardedly, used for purposes of illustration. But if inferences are to be drawn from such analogies, too great care cannot be taken to determine wherein the analogy consists; an inquiry which may often resolve itself into an inquiry how far the reasons for the application of the rule to the one legal institution hold good for the application of the rule to the other. To illustrate, take the instance of a corporation, the shareholders of which are affected with personal liability for the debts of the corporation, judgment having first been obtained against the corporation, execution levied thereunder and returned unsatisfied. Suppose suit to have been brought against the corporation, judgment obtained, the execution thereunder returned unsatisfied, and that suit is brought against the shareholders personally. Some courts, reasoning from analogy, have held the shareholders liable as guarantors, while in other courts they have been held liable as partners. But the gene-

ral analogy between the liability of a surety and that of a shareholder is as misleading as the analogy between the liability of a shareholder and that of a partner. On the one hand, acts may be done which would discharge a surety from his liability, which do not discharge a shareholder from his; and, on the other hand, by a *bona fide* transfer of shares the liability of the shareholder may cease, while a partner, by selling out his interest in the firm, cannot free himself from his liability to partnership creditors. No. The liability of a shareholder in respect of his shares in such a corporation, is the liability neither of a surety nor of a partner, for the reasons which led to the formation of the rules regulating the liability of a surety or of a partner are not necessarily, or even probably, present. The liability in question is, properly speaking, the liability of a shareholder in that particular corporation, and is determined by the rules contained in the corporate constitution.¹

§ 69. There are, however, elements in the liability of a shareholder in such a corporation which are in truth analogous to certain elements in the liability of a surety or partner. But these elements are the manifestation of legal rules common to all three kinds of institutions, and, therefore, to be regarded no more as rules of corporation law than as rules of the law of partnership or suretyship. They are rather legal rules of almost universal application, reasons for which exist in respect of almost all legal institutions. They are rules which, like the rule that for a valid contract there must be a consideration, form the basis of the law of contracts, or, like the rule that a man is responsible for the ordinary consequences of his acts, form the basis of the law of torts.

§ 70. The second method by which courts may form new rules of law, is by applying to the case in question general principles of law of extended application. The objection to this method is that it is well nigh impracticable on account of the difficulty in determining what are these general principles of law. Still, this objection is not insurmountable. However much jurists may differ in regard to the science of jurisprudence, that there is

The appli-
cation of
general
principles.

¹ See, for a fuller discussion of this question, §§ 712-720.

some such science founded on general principles in themselves logical, just, or farseeingly expedient, according as one may phrase it, few would deny. It is not necessary for jurisprudence that it should be based on principles, true, just, or expedient for all time. It is enough for such a science that it be based on foundations that will last out a generation or two. As such, it will be the expression of the systematized common sense or intelligence of men specially trained in law.

§ 71. Indeed, to form a new rule based on general principles of law, is no more than forming a rule which shall not shock the trained intelligence of jurists; and such a rule will be consistent with the law as a whole, in so far as any rule can be consistent with a huge body of rules, some of which are inconsistent with the rest. Forming a new rule of law amounts to little more than deciding a novel case in accordance with what seems to the court, considering the general state of the law and of society, to be on the whole most expedient or just. The danger arising from reasoning from the analogy of different legal institutions is, lest a rule of law be applied where the reasons for its application fail; and in truth, where a rule of law already identified with one legal institution is advantageously applied to another, it will be because good reasons for the application of the rule exist, and not because of the resemblance of one institution to a fancied prototype.

CHAPTER V.

LEGAL RELATIONS ARISING THROUGH THE PROMOTION
OF A CORPORATION.¹

The law applicable, § 72.

Two classes of persons interested, § 73.

Liability of promoters. General principles, §§ 74, 75.

Legal relations between promoters and parties contracting with them, § 76.

Responsibility of promoters for the acts of other promoters, § 77.

Liability of contracting promoter whose contract binds, or is adopted by, other promoters or the corporation, §§ 78, 79.

Legal relations between promoters, §§ 80, 81.

Legal relations between promoters and the corporation subsequently formed; promoters' secret profits, §§ 82-84.

Right of promoters to indemnity from the corporation subsequently formed, § 85.

Liability of corporation to compensate promoters, § 86.

Legal relations between the corporation when organized and persons with whom the promoters have contracted on its behalf, §§ 87-90.

§ 72. A GENERAL remark may be premised in regard to the group of topics under consideration in this and the succeeding chapter: Incorporation not having as yet taken place, the rules of law in the constitution of the corporation are not yet in operation, and "corporation law" as such will usually be found inapplicable. Consequently, the various rights and liabilities arising through the promotion of a corporation will be determinable in accordance with the general principles of the law of contracts, of agency, and of partnership. We are, for the most part, dealing with contracts made by certain persons with certain others, which, to be sure, have some ulterior end in view, as contracts usually have; but the fact that this ulterior end is the incorporation of a company does not necessarily affect the rules of law by which these con-

¹ This and the next chapter lead up to the discussion of the legal effect of acts done subsequent to incorporation by or on behalf of the body corporate.

tracts are to be regulated, and the relations arising from them determined. The preceding statement, however, must be taken with this qualification: the fact that the ulterior end of these contracts was the formation of a corporation may give such corporation, when formed, rights, and even subject it to duties in regard to such contracts and their subject-matter.

§ 73. The persons interested in the formation of a corporation may be roughly divided into two classes: (1) Persons who actively take part in the scheme of organization, and (2) persons who merely subscribe for, or agree to take shares in the stock of the corporation to be formed. Very often, perhaps usually, the same persons who promote the scheme of organization subscribe for shares in the stock of the future corporation; but their functions as promoters and as subscribers are distinguishable, and for a proper determination of the legal relations arising through the promotion and formation of a corporation these two classes of functions should be kept distinct.

Two classes
of persons
interested.

§ 74. Persons acting in concert to bring about the formation of a corporation are responsible for their acts as a matter of course, and, if they have given good reason to infer that they will be responsible for the acts of each other, then on the ground of estoppel, if on no other, they will be so responsible to any person acting on the faith of the inference which their acts have occasioned. Accordingly, if they have held themselves out as each other's principals, or as each other's partners, although no relationship of agency or partnership in fact exists between them, they will be estopped from taking advantage of the real state of affairs to the detriment of persons who have acted, and with reason, on a belief in the existence of such agency or partnership.

Liability of
promoters.
General
principles.

§ 75. In fine, on the general principle that a man is to be held responsible for the natural and ordinary results of his acts, the following propositions may be laid down as governing many of the rights and liabilities of the promoters of a corporation:

I. A man is bound for the fulfilment of a contract entered into by him, and is, of course, personally liable thereunder

when the other contracting party has no reason to suppose him to be acting merely as agent.

II. A. will be liable for all acts done by B. within the scope of any authority which A. by his acts or representations has induced other persons to suppose that B. has received from A., at least towards those persons who have acted reasonably and in good faith on belief so occasioned; and in such case, A.'s liability for B.'s acts will be identical whether the relationship, which A. has caused to be believed to exist between himself and B., actually exists or not.¹

III. If A. contracts as agent, when in fact he has no principal or no authority from his principal to make the contract in question, A. will be personally liable, not necessarily on the contract, but on an implied warranty of authority;² except where the extent of A.'s authority is known to the other contracting party,³ or is a matter with knowledge of which the other contracting party is affected by some rule of law.⁴

IV. If A. contracts as agent, when in fact he has no authority to make the contract in question, and yet the circumstances are such that some one is held liable as principal (in accordance with Proposition II.) to the other contracting party, or if the person or body for whom A. purported to contract ratifies the contract,⁵ A. will not be personally liable to the other contracting party, unless there is evidence that credit was given to A. personally;⁶ for any implied warranty of authority is unbroken.

V. In the instance stated in that part of the preceding proposition governed by Proposition II., A. might be liable in damages to his principal or partner.⁷

VI. When A. contracts as principal and agent as well, that is, as a partner, he will be liable personally on the contract, and the liability of those for whom he contracts will be governed by the rules stated in Proposition II.

VII. When an act has been done by A. as agent, when in

¹ See Story on Agency (9th ed.), § 443. the Liability of Officers and Agents of Corporations, pp. 77-80. Compare §§

² Story on Agency, §§ 264, 264 a. 752-754.

³ Story on Agency, § 265.

⁵ Story on Agency, § 251.

⁴ See *Jefts v. York*, 4 Cush. 371; ⁶ See Story on Agency, §§ 263, 423.

S. C., 10 Cush. 392; Thompson on ⁷ Story on Agency, § 217 c.

fact A. either had no principal, or, having a principal, had no authority from him to do the act in question, and nothing had been done by the person or body on behalf of whom the act was done by A., from which authority to do the act could have been inferred,—in neither case can such person or body adopt or ratify the act of A. without incurring all the liability which would have attached to such person or body had the requisite authority from him or it to do the act in question in fact existed at the time when the act was done.¹

VIII. The preceding proposition holds good as to the liability incurred by the subsequently ratifying principal towards the other contracting party, only in the absence of express agreement in regard thereto; and in like manner, by express agreement between the agent and his principal subsequently ratifying, the liability of the latter to indemnify the former may be varied.

IX. An agreement to enter into partnership at some future time does not make the parties thereto partners, at least before the arrival of the time specified.²

§ 76. Except in the case of illegal contracts, or where the authority of an agent is known to the other contracting party, or is a matter with knowledge of which the other contracting party is affected, there is no question that when a person contracts with another he is liable personally for the damages arising from the non-performance of his side of the contract, unless he contracts so as to bind some one else to perform his side of the contract, and the other contracting party knows; or should know, that the contract is made on behalf of that outside person, and so may fairly be presumed to give credit to him. It follows that a promoter of a future corporation ordinarily is personally liable to the other contracting party, because the

Legal relations between promoters and parties contracting with them.

¹ See Story on Agency, §§ 242–244, 250, 251, 419, 445; also Lindley on Partnership (Am. ed.), vol. ii. pp. 755–758, star paging. *Ratihabitio mandato comparatur*, Dig. lib. 46, tit. 3; De Sol. Sen. 12, § 4. *Si quis ratum habuerit quod gestum est, ob-*

stringitur mandati actione. Dig. lib. 50, tit. 17; De div. reg. jur., § 60. See Year Book, H. 7 (H. 4), fo. 34, pl. 1.

² See Lindley on Partnership (Am. ed.), vol. i. pp. 27–33.

promoter has no principal;¹ and the subsequent adoption of the contract by the corporation when organized will not free the promoter from his liability to the other contracting party without the consent of the latter,² because it cannot be presumed that a party contracting gives credit to a corporation not yet organized, and therefore not yet capable of being bound. Of course it is competent for the promoter to stipulate that the contract shall not be binding unless the corporation is subsequently organized; but in this case the promoter simply makes a conditional contract. So, further, it might be agreed between the contracting parties that in no event should the promoter incur any personal liability, but that the contract should be binding only on the corporation to be subsequently formed.³ In such case the promoter would not be liable; the other party could at any time withdraw as long as his side of the contract remained executory, unless he had in the meanwhile received some valid consideration for his promise; and as for the corporation, ordinarily it would not be bound by the contract unless it adopted the same after its organization.⁴ It is plain that any

¹ If officers of a corporation purport to sign a note on its behalf before its organization, they will be personally liable thereon. *Hurt v. Salisbury*, 55 Mo. 310; see *Hopcroft v. Parker*, 16 L. T. N. S. 561.

² "There must be two parties to a contract, and the rights and obligations which it creates cannot be transferred by one of them to a third person who was not in a condition to be bound by it at the time when it was made." Erle, C. J., in *Kelner v. Baxter*, L. R. 2 C. P. 174. It is plain that while a party may assign his rights under a contract, he may not thereby free himself from his liabilities; but it might be inferred from the words of the chief justice that it was incompetent for a corporation to adopt any contract made on its behalf by one of its promoters prior to its organization, which seems unreasonable.

Still, *Scott v. Lord Ebury*, 36 L. J. C. P. 161, holds that a corporation subsequently formed cannot ratify the acts of a promoter so as to relieve him of his liability arising from them, because the corporation "was not in existence" when the liability was incurred. In this latter case, however, the court, who by agreement were allowed to draw inferences of fact, considered that the contract was made on the credit of the promoters and that there was no evidence of a consent on the part of the other contracting party to substitute the liability of the corporation.

³ *Landman v. Entwistle*, 7 Exch. 632; see *Higgins v. Hopkins*, 3 Exch. 163; *Rennie v. Clarke*, 5 Exch. 292.

⁴ As to the responsibility of the corporation in regard to contracts of its promoters, see §§ 87-90.

contract like the last would be of a very doubtful and conditional nature, and such as a court would never imply, or allow a jury to imply, unless all other interpretations were excluded by the terms of the contract itself.

§ 77. Thus far in regard to the personal responsibility of the promoter who himself makes the contract in regard to which the question of his liability arises. As to his responsibility for the acts of his co-promoters other principles of law are involved, which it was attempted to formulate in Propositions II., VII., VIII., and XI. Promoters of a corporation are not presumptively partners,¹ and they do not become such merely by becoming bound on the same instrument. Accordingly, a promoter is not responsible for the contracts of other promoters in the absence of evidence that he has authorized the others to contract for him or pledge his credit.² Nevertheless, applying principles stated in the propositions referred to, if promoter A. causes any person, acting reasonably, to believe that promoter B. is his agent, A. will be held liable as principal for whatever B. does within the scope of whatever agency A. by his conduct has caused to be inferred to exist between himself and B. Likewise, promoters will be held liable as partners if they have held themselves out as such, or negligently or fraudulently allowed themselves so to be held out by their co-promoters. Thus a prospectus of a projected company, to be formed for the conveyance of immigrants to British Columbia, contained

Responsibility of a promoter for the acts of other promoters.

¹ *Reynell v. Lewis*, 15 Mees. & W. 517; *Bailey v. Macaulay*, 13 Q. B. 815; 1 *Lindley on Part.*, pp. 31-33.

² *Patrick v. Reynolds*, 1 C. B. N. S. 727; *Burbridge v. Morris*, 3 H. & C. 664; *Wilson v. Curzon*, 5 Eng. Railway Cas. 24. *A fortiori* a promoter is not responsible for the contracts of other promoters entered into before he became in any way connected with the enterprise; *Beale v. Moulds*, 5 Eng. Railway Cas. 105.

In an action against a provisional committee-man on a contract entered

into by the committee of management, appointed by the provisional committee, it is a question for the jury whether the defendant appointed the managing committee his agent to pledge his credit. Where, however, nothing else appears than that there is a managing committee appointed by the provisional committee, the jury ought not to conclude that the former has authority to pledge the credit of the latter; *Williams v. Pigott*, 5 Eng. Railway Cas. 544; see *Dawson v. Morrison*, *ib.* 62.

statements calculated to induce belief that arrangements had been perfected for carrying passengers overland, and invited persons to take passage tickets. The defendants allowed their names to be inserted in this prospectus as directors in the contemplated company, receiving for the use of their names two hundred paid-up shares and a promise of indemnity. The prospectus, with their names attached, was published in the Times. It was held that a jury were warranted in inferring that a person who contracted for his passage with the secretary did so on the faith of these representations in the prospectus; and that such a person could recover damages from the defendants, the representations proving untrue.¹

§ 78. One other statement in regard to the liability of promoters may be ventured. When a promoter makes a contract merely as agent for the other promoters, who have not as a matter of fact authorized him to make the contract in question, but who have acted in such a way as to justify others in believing that such authority had been given, so that the party contracting with the promoter is enabled to hold the other promoters on the contract, he cannot hold the promoter personally who contracted merely as agent; not on the contract, for the contract purported to bind the other promoters only, and not on the breach of any implied warranty of authority, for the other promoters were in fact bound by the contract.² This, in practice, would prevent the party with whom the promoter contracted as agent from choosing whom to sue. It would not be competent for him to proceed against the agent on the ground that the agent had actually no authority to make the contract; for that is something with which such contracting party has nothing to do, provided he can hold the principals. His interest is in no way affected, as he gave credit to the principals, not to the agent; and as long as the very persons to whom he gave credit are bound to him what more can he claim? All else is merely a matter to be settled

Liability of contracting promoter whose contract binds or is adopted by other promoters or the corporation.

¹ Collingwood v. Berkeley, 15 C. B. 145; see also Maddick v. Marshall, 17 C. B. N. S. 829; Lake v. Argyll, 6 Q. B. 477; Wood v. Argyll, 6 M. & G. 928.

² See Proposition IV., § 75.

between the agent and his principals. Moreover, when promoters adopt acts of one of their number, in regard to which no liability would otherwise have attached to them, they assume all liability which would have attached to them had the act been authorized by them before it was done. They must ratify *in toto*, if at all, unless of course the other contracting party, with full knowledge of the situation, agrees to a variation from the original liability.¹

§ 79. Reasoning by analogy from the above, it would seem that in so far as the subsequently formed corporation assumes the liability of the promoter, who contracted *as its agent*, towards the other contracting party, who contracted with the promoter as the agent of the corporation, and gave credit to the corporation, knowing that it had not yet been organized—something highly improbable,²—the personal liability of the promoter would cease; and for the same reasons as before; for it was to the corporation that the other contracting party gave the credit, and the corporation has assumed the liability. To be sure, if the other contracting party did not know that the corporation was unorganized at the time, he cannot justly be presumed to have contracted on its credit; and therefore no subsequent ratification by the corporation would free the promoter from personal liability; and, if the promoter represented that the corporation was organized when the contract was made, he would be liable in an action for deceit.

Finally, while it may be true that the subsequently formed corporation agrees by implication, on adopting the contract of its promoter, to indemnify him from all liability under the same, and this because the corporation is entitled to the full benefit of the contract,³ yet this reason fails when considering the rights of the other contracting party, who may have good grounds for refusing to accept the exclusive liability of a body

¹ See Propositions VII. and VIII., § 75.

² It could never be *presumed* that a party contracting with a promoter gave credit to a body not yet organized. Therefore evidence would be required

to establish the fact that credit was given to the corporation; and, unless the whole transaction had been reduced to writing, this would be a question for the jury, see § 76.

³ See §§ 82-84.

which had not been organized at the time of making the contract.

§ 80. Promoters are bound to observe good faith in their dealings with each other, and one promoter must indemnify the others for damages arising from any unauthorized acts of his affecting their rights and interests. Should, for instance, one promoter without authority attach the names of his co-promoters to any prospectus or other document, he would be liable for their damages resulting. Moreover, although promoters may have acted in such a manner as to induce belief in outsiders that the relationship of agency or partnership exists among them, so that as to outsiders they have made themselves responsible for each other's acts, still, if no such relationship in truth exists, any promoter doing any act by which liability attaches to his co-promoters may be held to indemnify them. If, as a matter of fact, the relationship of agency or partnership exists between promoters, they will be held, as among themselves, to the strict accountability of trustees; and the legal and equitable rules, regulating agency and partnership, will be applicable.

§ 81. The principles of law applicable to persons becoming jointly bound on one instrument apply to promoters, and in such case, should one of them be obliged to pay the whole debt, he can enforce contribution from his co-debtors.¹ So, where promoters have made an agreement to share expenses, such agreement will hold good between them, and will be enforceable at the suit of any one of their number who may in good faith have paid more than his share of the expenses of the scheme. Promoters, or provisional committee-men, although not partners, are not entitled, in the absence of any special agreement, to remuneration from each other for their services in promoting the organization of the corporation.²

¹ Several provisional committee-men became *jointly* liable on the same contract. One of their number was forced to pay the whole debt. Subsequently he brought suit for contribution, some of his associates having died in the mean time. It was held, provisional committee-men not being partners,

that each was liable to contribute to the one who had paid the whole debt only the same aliquot part that each would have been obliged to contribute had there occurred no deaths; *Bataïd v. Hawes*, 2 El. & B. 287.

² *Parkin v. Fry*, 2 C. & P. 311. The case of *Holmes v. Higgins*, 1 B. & Cr.

§ 82. The relationship existing between the promoters and the corporation as subsequently organized is a fiduciary relationship, regulated by legal and equitable principles in many respects similar to those applicable to the relationship of agency.¹ Strictly speaking, a promoter cannot be called the agent of the corporation which has not yet been organized. It is nevertheless true that if a person acts in such a way as to give rise to the reasonable presumption that he is acting in the interests of a corporation about to be formed, and other men act, relying on his acts and representations, believing him to be acting as he appears to be acting, such a person will be estopped from denying that he was acting in the interests of the future corporation, when such a denial would injure others who have acted upon the faith of his acts and representations. Moreover, if the facts correspond to the appearances, which correspondence he will not be allowed to controvert, and he is really acting in the interests of the future corporation, his relations thereto can be regulated only by rules similar to those prevailing in the law of agency. Therefore, speaking elliptically, he will be estopped from denying that he acted as the agent of the corporation. Accordingly, as against a person acting as promoter, the corporation is entitled to the full benefit of all acts done and contracts made by him while acting in that capacity; and the promoter, as between himself and the corporation, is entitled to no secret profits; he may not purchase property for the corporation, and then sell the same to the cor-

Legal relations between promoters and the corporation subsequently formed. Promoters' secret profits.

74, decides the same point in the same way, but on the ground that promoters are partners; in this respect the case is no longer law; see § 77.⁶

¹ But not in every respect; for the corporation, in the nature of things, not having entrusted its property to the promoter, never having employed the promoter to act for it, and not being bound by his contracts unless it ratifies or voluntarily accepts the benefit of them after its incorporation, could ordinarily bring no such action against a

promoter for misfeasance as a corporation could bring against one of its officers. A promoter, to be sure, would be liable to the corporation in damages for any fraud committed by him in contracting with it of a nature that would render one individual liable under ordinary circumstances to another. But usually the only action maintainable by a corporation against its promoters is an action to make them disgorge secret profits.

poration at an advance.¹ And if a promoter, in payment for property belonging to him or in which he is pecuniarily interested, receives from the corporation moneys which, as being secret profits, he is not entitled as against the corporation to retain, and distributes a portion of these profits among his co-promoters or associates, he will be liable to refund to the corporation, not only the profits retained by himself, but also those which he has thus distributed.²

§ 83. If, however, a person owning a piece of property becomes a promoter in a scheme of incorporation, even when the scheme relates to the development of this very piece of property, he may sell the property to the corporation, and have his price paid without regard to the original cost of the property to him;³ for, when he acquired the property, *ex hypothesi* he did

¹ *Simons v. Vulcan Oil Co.*, 61 Pa. St. 202; *Short v. Stevenson*, 63 Pa. St. 95; *Chandler v. Bacon*, 30 Fed. Rep. 538; *Hickens v. Congreve*, 1 R. & M. 150; *Beck v. Kantorowicz*, 3 K. & J. 230; *New Sombrero Phosphate Co. v. Erlanger*, L. R. 5 Ch. D. 73; *aff'd*, 3 App. Cas. 1218; *Phosphate Sewage Co. v. Harmont*, L. R. 5 Ch. D. 394; *Bagnal v. Carlton*, L. R. 6 Ch. D. 371. "Nothing is more common than for persons to acquire property, to form a company on purpose to buy it, and to conceal their own true position from the company they so form. Such a transaction can never stand." 2 *Lindley on Part.*, 580. The same principles hold in transactions looking towards the formation of an ordinary partnership. See *Fawcett v. Whitehouse*, 1 R. & M. 132; and in general, *Tyrrell v. Bank of London*, 10 H. L. C. 26.

² *Getty v. Devlin*, 70 N. Y. 504.

³ See *Gover's Case*, 1 Ch. D. 182, which discusses how far a person promoting the formation of a company to develop property belonging to himself may act towards the company, in sell-

ing his property to them, as towards an outsider to whom he owes no special duties. The case did not decide the point under discussion in the text, *i. e.*, that such a person could sell at a profit and retain the profit, but merely that his having done so was no ground to sustain an application on the part of a shareholder for the removal of her name from the list of shareholders on the winding up of the company. The case was not considered to conflict with the cases cited in the last note. See *James, L. J.*, in 5 Ch. D. 118. *Dorris v. French*, 4 Hun, 292, resembles *Gover's Case*, and decides the same point the same way. It was held in a recent English case that if a promoter sell his own property to the corporation without declaring the fact that it is his, the corporation may rescind if in a position to do so, but cannot compel the promoter to pay over the difference between what he paid for the property at a time when he was not a promoter and what the corporation paid him for it. *In re Cape Breton Co.*, 26 Ch. Div. 221; *aff'd*, 29 Ch. Div. 795.

not act as promoter. Nevertheless, if at the time of making the sale to the corporation he occupies towards the corporation, as promoter or otherwise, a position of trust and confidence, while he may sell without reference to the original cost of the property to him, yet it would seem, on general principles of law and equity applicable to persons holding positions of trust, that he should not be permitted to sell at an unfair or exorbitant price.¹ Accordingly, it becomes of importance to determine, as nearly as the nature of the case will permit, the point of time when any person begins to act as a promoter, and so presumably in the interests of a company to be organized. This can be determined only from his acts and representations. Does he hold

¹ See the cases cited in the last two notes. Perhaps the last sentence in the text does not accord with the view taken by Sharswood, C. J., in *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43, 49. “. . . Any man or number of men who are the owners of any kind of property may form a partnership or association with others, and sell that property to the association at any price which may be agreed on between them, no matter what it may have originally cost, provided there be no fraudulent misrepresentations made by the vendors to their associates. They are not bound to disclose the profit they may realize by the transaction. They were in no sense agents or trustees in the original purchase, and it follows that there is no confidential relation between the parties which affects them with any trust.” The last sentence seems to contain a *non sequitur*; i. e., A. did not occupy a position of trust towards B. when A. acquired the property, therefore A. does not hold such a position towards B. when A. sells the property to him. The original cost is immaterial; the property may have been given to the promoter; but it does not follow that he may sell to his associ-

ates at an exorbitant price. Moreover, the sentence referred to is hardly consistent with the following from the same opinion. “. . . Where persons form such an association, or *begin or start the project of one, from that time they do stand in a confidential relation to each other*, and to all others who may subsequently become members or subscribers; and it is not competent for any one of them to purchase property for the purposes of such a company, and then sell it at an advance, without a full disclosure of the facts. They must account to the company for the profit, because it is legitimately theirs.” The learned judge seems to think that the property must have been acquired during the existence of the fiduciary relation, in order to charge the seller with any of those duties towards his vendee which persons standing in a confidential relation owe each other; but this seems not essential, for the maxim *caveat emptor*, and the rules of law proceeding from it, never apply between persons occupying positions of mutual trust and confidence; see also *Lungren v. Pennel*, 10 Weekly Notes of Cases (Pa.), 297.

himself out generally in what he says and does as promoting the formation of a corporation? and does he represent himself as acting and contracting on its behalf or for its ultimate benefit? It would seem that the character of promoter should be held to have been assumed at any time when these questions could have been answered generally in the affirmative.¹

§ 84. The application of the foregoing principles is illustrated by *McElhenny's Appeal*.² *McElhenny*, not acting as a promoter, sold some property to persons who were getting up a company, to which they in turn intended selling the property. He then united with the promoters, and they all together turned the property over to the corporation at a large advance. Afterwards the corporation, discovering these facts, brought suit against *McElhenny*, or rather against his executors, as he had died in the mean time, to make his estate refund the profits he had made from the two sales of his property. The Supreme Court of Pennsylvania held, that the estate was entitled to retain the profits which *McElhenny* had made from his first sale to the promoters, but should pay back the profits he had derived from his interest in the subsequent sale from the promoters to the corporation.

§ 85. It is probably true, as a general legal proposition, that when A. makes a contract for B., who is not as yet A.'s principal, while A. becomes responsible from the outset, for the performance of the contract made by him, B., by assuming the contract as principal,

¹ "On the one hand, it is plain that a fiduciary relation between a promoter and a company may exist long before the actual formation of a company by registration. On the other hand, it is obvious that something must be done beyond a purchase and a resale to constitute such a relation; something must, it is submitted, be done by the promoter to impose upon him the duty of protecting the interest of those who ultimately form the company. He assumes this duty if he assumes to act for them, or if he induces them to trust

him, or to trust persons who are under his control, and who are practically himself in disguise; he also assumes this duty if he calls the company into existence in order that it may buy what he has to sell; but he does not assume such duty by negotiating with persons who have themselves assumed that duty, and who are in no way under his influence." 2 *Lindley on Part.*, 585. See *Albion Steel and Wire Co. v. Martin*, 1 Ch. D. 580.

² 61 Pa. St. 188.

thereby assumes to indemnify A. from any liability under the contract towards the other contracting party. This agreement to indemnify would be implied, and B. would become principal as from the time of making the contract. Where B., however, who subsequently as principal assumes the contract made by A. as agent, is a corporation which was not organized at the time of making the contract, apparent difficulties arise. It would seem illogical to imply—and the discussion at present is confined to cases where no express assumption of liability is made—any agreement on the part of the corporation, which at the time of making the contract could have had no agent, to indemnify any one who at that time attempted to act on its behalf. Nevertheless, as under such circumstances the corporation would be entitled to the full benefit of the contract made by its promoter, and, as towards the corporation, the promoter would be charged with the duties and liabilities of an agent, it seems no more than equitable that an agreement should be implied on the part of the corporation to indemnify the promoter, in so far as the corporation has voluntarily accepted the benefit of the contract, against any liability towards the other contracting party.¹ This would hold good, however, only in those cases where the original contract as made by the promoter would not have been *ultra vires* the corporation after its organization.²

The corporation, moreover, could expressly agree to assume any liability incurred by the promoter contracting on its behalf; but such an agreement, were it other than the law under the circumstances would imply, would be a new contract, and would have to be supported by a valid consideration and be within the powers of the corporation.

§ 86. In England by statute many companies are required to pay the expenses which are incurred in their formation; and when such a statute applies, a member of the company will be entitled to be paid for his trouble and time in forming it.³

¹ See *Parsons v. Spooner*, 5 Hare, 102.

² Thus a corporation is not liable to repay money advanced for the purpose of influencing the legislature to incor-

porate it. *Marchand v. Loan and Pledge Association*, 26 La. Ann. 389.

See generally also §§ 87-90.

³ *Carden v. General Cemetery Co.*, 5 Bing. N. C. 253; see *In re Bramp-*

In the absence, however, of any statute, it is the law throughout the United States that the corporation subsequently formed is not liable to compensate its promoters for their services in forming it and procuring subscriptions to its stock; for, aside from the technical difficulties in the way arising from the fact that the corporation was not incorporated at the time when the services were rendered, it is thought reasonable to regard such services as having been given in view of the benefit expected from the organization of the company.¹ If, however, after its incorporation, the corporation recognizing the services of its promoters, expressly promises to pay for them, an action will lie against it on this express promise;² and likewise, if, after its incorporation, it ratifies the promises of its promoters to pay for the services of other persons performed for it before its incorporation, an action will lie on this ratification.³ And such a ratification will arise if the corporation, after notice that the services were rendered on promises of the promoters that they should be paid for, voluntarily accepts the benefit.⁴

§ 87. I may be said, generally, that a corporation when organized, in the absence of ratification on its part, is not responsible for the acts nor bound by the contracts of its promoters,⁵ unless made so by its charter,

ton v. Longtown R'y Co., L. R. 10 Ch. 177; *Hitchens v. Kilkenny R'y Co.*, 9 C. B. 536.

¹ *Rockford Rock Island, etc., R. R. Co. v. Sage*, 65 Ill. 328; *Bell's Gap R. R. Co. v. Christy*, 79 Pa. St. 54; *New York and New Haven R. R. Co. v. Ketchum*, 27 Conn. 171; *Hall v. Vermont and Mass R. R. Co.*, 28 Vt. 401; *Marchand v. Loan and Pledge Association*, 26 La. Ann. 389. Compare *Perry v. Little Rock, etc., Ry. Co.*, 44 Ark. 383.

² See *Western Screw and Mfg. Co. v. Cousley*, 72 Ill. 531; *Franklin Fire Ins. Co. v. Hart*, 31 Md. 59.

³ *McDonough v. Bank of Houston*, 34 Tex. 309; compare *Safety Deposit Life Ins. Co. v. Smith*, 65 Ill. 309.

⁴ *Low v. Connecticut and P. R. R. Co.*, 46 N. H. 284.

⁵ *Gent v. Insurance Co.* 107 Ill. 652; *Penn Match Co. v. Hapgood*, 141 Mass. 145; *Munson v. Syracuse, etc., R. R. Co.*, 103 N. Y. 58; *Payne v. New South Wales Coal Co.*, 10 Ex. 283; *Gunn v. London and Lancashire Fire Ins. Co.*, 12 C. B. N. S. 694. See 1 *Lindley on Part.*, 395; *Hutchinson v. Surrey Consumers' Gas Light Ass'n*, 11 C. B. 689.

which it has accepted and thereby agreed to.¹ But this is not identical with the proposition that the corporation may ignore the engagements entered into by its promoters, when it has had the benefit of them.

It cannot be said that the promoters were the agents of the corporation; but, nevertheless, the corporation may adopt such acts of its promoters intended for its benefit, and may ratify such of their contracts made on its behalf, as would have been within the powers of the corporation after its organization; and this it may do notwithstanding that it was not organized when those contracts were made.² And if it

tion when organized and persons with whom the promoters have contracted on its behalf.

¹ *Tilson v. Warwick Gaslight Co.*, 4 B. & C. 962. See *Shaw's Claim*, L. R. 10 Ch. 177; and *Caledonian, etc., R. Co. v. Helensburgh*, 2 Macqueen, 391.

² *Whitney v. Wyman*, 101 U. S. 392; *Spiller v. Paris Skating Rink Co.*, 7 Ch. D. 368. See *Penn Match Co. v. Hapgood*, 141 Mass. 145, 149. It must be admitted that a number of English cases, criticised in *Spiller v. Paris Skating Rink Co.*, have held that a corporation could not ratify the acts of its promoters, because not in existence when the acts were done. See *Kelner v. Baxter*, L. R. 2 C. P. 174 (*ante*, § 76); *Scott v. Lord Ebury*, 36 L. J. C. P. 161 (*ante*, § 76); and *Melhado v. Porto Alegre R. Co.*, 9 C. P. 503. In the last case *Coleridge, C. J.*, seemed to think such cases should be decided differently, but could "find no legal principle" upon which an action brought against a corporation on a contract made by its promoters before, and ratified by it after, its organization could be maintained.

It may be true, according to the common law, that no mere stranger, on whose behalf an agent did not even pretend to act, may ratify the contracts of such an agent so as to require rights

or incur liabilities in regard thereto, towards the other contracting party. See *Wilson v. Lumman*, 6 Man. & Gr. 236. And it is said in the Digest: "*Ratihabitio constituet tuum negotium, quod ab initio tuum non erat, sed tua contemplatione gestum.*" Dig. lib. 3 tit. 5; *De Neg. Ges.* 5, § 11. (*Mommsen's ed.*; otherwise cited as 6, § 9.) But at common law a *chose in action* was regarded as non-assignable; and in the Roman law the competency to acquire rights and incur liabilities through an agent was of late growth. Moreover, a promoter does purport to act on behalf of the future corporation; and the future corporation, as between itself and its promoter, is entitled to the full benefit of his acts (see §§ 82-84); and it is only through the acts of its promoters that a corporation is formed. To say that the corporation when organized cannot adopt and ratify such contracts of its promoters made on its behalf, as would have been within its powers to enter into after its organization, is to say that a body of men, when incorporated and acting as a corporation, cannot ratify those contracts (of some of their number, probably) which it would be competent for them, acting

ratifies their contracts, then, in the absence of express agreement with the other contracting party, the corporation must be

as a corporation, to make, and which were made on their behalf, and in order that they might subsequently act as a corporation. Instances would seem hard to find where ratification could more properly take place.

There is, however, another question, which has nothing to do with the doctrines of ratification in themselves considered. Suppose that a corporation has been formed, and that a given act is within its powers of corporate action. This act was done on behalf of the corporation, by its promoters prior to its organization. May it not be said in such a case that, although it may be within the powers of the corporation to do such an act after its organization, yet, nevertheless, the corporate powers took their beginning at a certain time, and it may not have been the intention of the legislature to allow a body of men to act as a corporation prior to their incorporation, or to allow them to ratify acts done prior to their incorporation, as that might amount to the same thing? In other words, is it not *ultra vires* the corporation to adopt acts done prior to its organization, even though they be such acts as the corporation since its organization could legally perform? A reasonable view of this question should be taken. Undoubtedly a corporation cannot legally act as such before its organization, and, therefore, cannot legally adopt a long series of acts of the same nature as those which it was organized to perform. It cannot begin its corporate action and take up its corporate business as from a time long anterior to its organization. But, properly speaking, only such acts can be regarded as acts

of promoters which have for their final object the formation of a corporation. It does not come within the functions of promoters to carry on a business, but only to form a corporation to carry one on. It would be absurd to hold acts, extending through years, done in a business similar to that to be carried on by the corporation when formed, to have been done on behalf of a future corporation. At the same time it would be a strained, not to say absurd, doctrine to hold it *ultra vires* a corporation to adopt those acts of its promoters done on its behalf, which it could itself legally perform since its organization, and which were proper and reasonable acts for its promoters to do in order to bring about the formation of a company and start it on its corporate career. The proper test to apply to such cases is not: would the contract in question have been within the powers of the corporation had it been organized when the contract was made? but, is it within the powers of the corporation to make the same contract now, supposing it had not been made then? or, can the company legally carry out that very contract? As Lord Chancellor Cranworth says, in *Preston v. Liverpool and Manchester R. Co.*, 5 H. L. C. 605: "It can only be that contracts which the railway company might lawfully have entered into after the company had been formed shall be binding, if they were entered into by those who might be considered as agents for the company before the company came into corporate existence." To illustrate: suppose certain persons, with a view of forming an insurance company,

held to have assumed the liabilities which would have attached to it, had its promoters been its agents at the time when they contracted on its behalf.¹ The English courts, moreover, have gone a step further, and have held, even where there has been no ratification by the corporation, that a corporation should not be allowed to use its powers, which it has been enabled to obtain through the engagements of its promoters, in disregard of those engagements and to the prejudice of the persons with whom those engagements were made.

§ 88. On this point, the leading case is *Edwards v. The Grand Junction Railway Co.*² There the promoters of a railway company met with opposition from the trustees of a turnpike road. It was agreed between them that the trustees should withdraw their opposition to the company's bill, and that the company should, if the bill passed, carry the turnpike road over a bridge of certain dimensions. The trustees withdrew their opposition, and the bill passed; but the company refused to

and wishing to find out for certain how much business such a company would get from the beginning, go about making contracts of insurance on behalf of the future company, the insurance to begin at a point of time anterior to the formation of the company; the company is afterwards organized. These were contracts which the company could legally have made had it been organized at the time; yet it seems doubtful whether the company could assume those contracts so as to render itself liable for losses which occurred before it was organized. If the promoters had contracted that the company should insure, the insurance to begin with the formation of the company, in that case the company could have adopted and ratified the contracts; for, after its organization, it could legally have made those very contracts. Compare *Gent v. Insurance Co.*, 107 Ill. 652. Again, suppose promoters agree that the incorporators

shall pay the reasonable legal expenses of its organization. This agreement, undoubtedly, the corporation can adopt and ratify; for, not only can it legally fulfil this agreement, but it could itself competently agree to pay those very expenses.

As to what will not constitute a ratification by the company, it is held in England that articles of association are a contract of the shareholders *inter se*, and therefore an outsider cannot base an action against the company on any of their provisions. *Eley v. Positive Assurance Co.*, 1 Ex. D. 20 and 88; but see *Touche v. Metropolitan Warehousing Co.*, L. R. 6 Ch. 671:

¹ See Propositions VII. and VIII., § 75.

² 1 M. & Cr., 650; acc. *Petre v. Eastern Counties R. Co.*, 1 Eng. R'y Cas. 462. See *In re Hereford Wagon Co.*, 2 Ch. D. 621; 1 Lindley on Part., 398-400. But compare *In re Rotherham Alum, etc., Co.*, 25 Ch. Div. 103.

perform. An injunction was granted to restrain the company from violating the agreement, and sustained on appeal. In giving judgment in the case, Lord Cottenham said: "But the question is not whether there be any binding contract at law, but whether this court will permit the company to use their powers under the act, in direct opposition to the arrangement made with the trustees prior to the act, upon the faith of which they were permitted to obtain such powers."

This case has been repeatedly questioned,¹ and its authority is doubtful. It may be hard for the party contracting with the promoter to have no remedy against the corporation; but he should have known that the promoter could not bind the future company, and it would work great injustice and hardship if the company were to be held liable on contracts made by its promoters which the charter or articles of association did not mention, and which persons taking shares in the stock of the company had no means of discovering.²

§ 89. In determining the liability of a corporation in regard to any contract made by its promoters on its behalf, the essential points to consider will be these: Was the contract one that the corporation as actually organized could legally have made after its incorporation; and, if so, has the corporation since its incorporation ratified the contract expressly, or impliedly by voluntarily accepting the benefit of the same in such a manner as to estop it from denying that it has ratified the contract?³

§ 90. The following propositions are submitted as an attempt to embody the law on the subject, supposing the contract made by the promoters to be one which the corporation after its incorporation could competently have made.

¹ See *Preston v. Liverpool and Manchester R. Co.*, 5 H. L. C. 605; *Caledonian, etc., R. Co. v. Helensburgh*, 2 Macqueen, 391; *Leominster Canal Co. v. Shrewsbury, etc., R. Co.*, 3 K. & J. 654; *Shrewsbury v. North Staffordshire R. Co.*, L. R. 1 Eq. 593. Still, the particular agreement in *Edwards v. Grand Junction R. Co.* would have satisfied the test of contracts ratifiable by the corporation in note 2 to

p. 57; and see *Williams v. St. George's Harbor Co.*, 2 DeG. & J. 547. But the contract never was ratified, and therein lies the difficulty with the decision.

² See *Caledonian, etc., R. Co. v. Helensburgh*, 2 Macqueen, 391, 405-407.

³ *Despatch Line v. Bellamy Mfg. Co.*, 12 N. H. 205; see *Fister v. La Rue*, 15 Barb. 323.

I. As long as the contract remains executory on both sides, the party who contracted with the promoter cannot enforce the contract against the corporation, unless the corporation has ratified the same; and the corporation cannot enforce the contract against the other contracting party, without carrying out all the engagements entered into with the other contracting party at the time of making the contract.¹

II. When a contract made by a promoter on behalf of a future corporation has been ratified and performed by the latter, it may force the party who contracted with the promoter to perform on his side.²

III. When the contract has been executed by the other contracting party, the corporation should be held to perform on its side, if (1) it has ratified the contract,³ or (2) voluntarily accepted the benefit arising from the performance of the contract in such a manner as to estop the corporation from denying that it has ratified the contract.⁴ But, on the other hand, if the benefit from the contract came to the corporation without any voluntary action on its part, or on the part of those whose acts in regard to the subject-matter of the contract are to be regarded as the acts of the corporation, then there is no principle in law or equity on which it can be compelled to carry out engagements entered into without its authority, and which it has never even impliedly ratified.

¹ *Burrows v. Smith*, 10 N. Y. 550. See *Richwald v. Commercial Hotel*

² See *Bedford and Cambridge R'y Co. v. Stanley*, 32 L. J. Eq. 60. *Co.*, 106 Ill. 439, 448.

³ Bonds issued by promoters before incorporation may, after incorporation, be ratified by the directors so as to become valid obligations of the corporation. *Wood v. Wheelen*, 93 Ill. 153. ⁴ *Bonner v. American Spiral Hinge Mfg. Co.*, 81 N. Y. 468; *Grape Sugar, etc., Mfg. Co. v. Small*, 40 Md. 395; *Little Rock and Fort Smith R. R. Co. v. Perry*, 37 Ark. 164; *Paxton Cattle Co. v. First Nat. Bank*, 21 Neb. 621.

CHAPTER VI.

LEGAL RELATIONS CONSEQUENT UPON AN AGREEMENT TO TAKE SHARES IN THE STOCK OF A CORPORATION TO BE ORGANIZED.

Is the agreement binding? § 91.

Consideration, §§ 92-95.

Conditional agreement to take shares, §§ 96, 97.

When deposits may be withdrawn, § 98.

Certain defences, § 99.

Legal relations arising from a valid agreement to take shares, § 100.

Assignment of subscriber's interest, §§ 101, 102.

Legal relations between subscribers and promoters, § 103.

When promoters are liable to subscribers for deposits, § 104.

Fraudulent subscriptions, § 105.

Misapplication of deposits, § 106.

Subscriptions in general enforceable by the corporation when organized, §§ 107-109.

Rights of subscribers against the corporation, § 110.

Effect of subscriber's laches, §§ 111, 112.

§ 91. In the first place, is an agreement to take shares in the stock of a corporation binding upon the parties thereto?¹ If the agreement is made as prescribed by statute and with persons, usually called commissioners, who, for the purpose of receiving subscriptions, are constituted by statute the representatives of the corporation while it is in the process of formation, the right acquired by the subscriber to shares in the company when formed, or, what is the same thing, viewed from the opposite point of view, the obligation which the company when formed will be under to allot shares to the subscriber, is a valid consideration for a subscription; if indeed it may not be said, that, when a statute specifies certain persons with whom agreements to subscribe are to be made, those agreements, provided the requirements of the

¹ See generally, *Kidwelly Canal Co. v. Eastern Plank Road Co.*, 20 Barb. 155; *S. C.*, 14 N. Y., 546. *Raby*, 2 Price, 93; *Selma and Tennessee R. R. Co. v. Tipton*, 5 Ala. 787;

statute are complied with, are good "by force of the act itself," without any further consideration; for the rule of law requiring a consideration is but a rule of law which like other rules may be modified by statute or impliedly abrogated in respect of certain contracts.¹

§ 92. When, however, the agreement to take shares is made simply by the subscribers among themselves, then taking for granted that the parties to the agreement are capable of contracting, and that the proposed objects of the contemplated corporation are not illegal, the question whether the agreement is binding resolves itself into a question

Consideration.

¹ Union Turnpike Co. v. Jenkins, 1 Caines Cas. 381; Hamilton and Deansville Plankroad Co. v. Rice, 7 Barb. 157. In the former of these cases Radcliffe, J., said, giving the opinion of the court at p. 389: "The subscription was taken by commissioners who were authorized to receive it, and in the form prescribed by the act. That form contains an absolute promise to pay the money to the president, directors, and company. On the one hand, the interest of the company in selling the shares, and the public advantage to be derived from the success of the institution; and on the other, the expected profits to accrue from the stock, were sufficient considerations to uphold the promise. By force of the act itself also it must be considered as good. The legislature also must have intended that it should be obligatory, for else the formal manner in which it was prescribed to be taken would be senseless and nugatory." This case was reversed in Jenkins v. Union Turnpike Co., 1 Caines Cas. in Error, 386, mainly on the ground that the terms of the statute had not been complied with. It still seems to the writer that the principle stated in the text and in the citation from Judge Rad-

cliffe's opinion is sound. See, also, Selma and Tennessee Railroad Co. v. Tipton, 5 Ala. 787, 809; Thorp v. Woodhull, 1 Sand. Ch. 411; Danbury and Norwalk R. R. Co. v. Wilson, 22 Conn. 435; and opinion of Bowie, C. J., in Taggart v. Western Maryland R. R. Co., 24 Md. 563. In Angell and Ames on Corp., § 527, it is said: "It seems that the criterion of the liability of a subscriber to stock in a corporation is whether any act has been done by which the corporation has been forced to receive the subscriber."

On the other hand, where signing a subscription paper is not an essential part of the machinery devised by the legislature for forming a corporation, it has been held that signing such a paper imposes no obligation on the subscriber which the corporation can enforce. Troy and Boston R. R. Co. v. Tibbits, 18 Barb. 297; Same v. Warren, ib. 310; Sedalia W. & S. R. Co. v. Wilkerson, 83 Mo. 235; see Erie and N. Y. City R. R. Co. v. Owen, 32 Barb. 616; Dorris v. Sweeney, 64 Barb. 636; S. C., 60 N. Y., 463. But see §§ 107-109.

As to the allotment by commissioners, see Crocker v. Crane, 21 Wend. 211; Walker v. Devereux, 4 Paige, 229.

as to the mutual sufficiency of consideration between the different parties.¹ It is often said rather loosely, that the mutual promises of the different contracting parties constitute the consideration for each other;² but to this it is answered with apparent pertinency, that, when the binding force of these very promises is in question, to say that they constitute valid considerations for each other is reasoning in a circle;³ still, perhaps, this objection is more specious than real. It is usually said that consideration is either benefit received, or trouble or detriment caused; but if the nature of consideration be looked into a little more closely, it will appear that, in reality, the detriment caused is at the present day the essential part of the considera-

¹ See *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546, 553 *et seq.* The promise to take the shares implies a promise to pay for them; *Spear v. Crawford*, 14 Wend. 90; approved in *Rensselaer, etc., Plank Road Co. v. Barton*, 16 N. Y. 457, note. See, also, generally as to this last, §§ 513, 514.

² *Twin Creek, etc., Turnpike Co. v. Lancaster*, 79 Ky. 552; *Watkins v. Eames*, 9 Cush. 587; *New Lindell Hotel Co. v. Smith*, 13 Mo. App. 7; *Osborn v. Crosby*, 63 N. H. 583. "The agreement to associate together under the act to accomplish the purposes designed would seem a sufficient consideration. The consideration need not move from the party with whom the contract is made. The consideration of one promise is that others will make like promises." *Shepley, C. J.*, in *Kennebec and Portland R. R. Co. v. Palmer*, 34 Me. 366. See *Edinboro' Academy v. Robinson*, 37 Pa. St. 210; *Thompson v. Page*, 1 Metc. 565.

³ *Methodist Episcopal Church v. Kendall*, 121 Mass. 528, holds that a gratuitous subscription to promote the objects for which a corporation is established, cannot be enforced unless the

promisee has done something or incurred some liability relying on the promise; and it is not sufficient that others were led to subscribe by the subscription sought to be enforced. See *Poughkeepsie, etc., Plank Road Co. v. Griffin*, 24 N. Y. 150; *Phillips Limerick Academy v. Davis*, 11 Mass. 113; *Essex Turnpike Co. v. Collins*, 8 Mass. 291; *Burt v. Farrar*, 24 Barb. 518; *Amherst Academy v. Cowles*, 6 Pick. 427. But see *Bryant v. Goodnow*, 5 Pick. 228, 229, where it is said: "Where one subscribes with others a sum of money to carry on some common project, lawful in itself, and supposed to be beneficial to the projectors, and money is advanced upon the faith of such subscription, an action for money paid, laid out, and expended may be maintained to recover the amount of the subscription, or such portion of it as will be equal to the subscriber's proportion of the expense incurred." See, also, *Homes v. Dana*, 12 Mass. 190; *Trustees of Farmington Academy v. Allen*, 14 Mass. 172; *Whitsitt v. Trustees Presbyterian Church*, 110 Ill. 125; *Osborn v. Crosby*, 63 N. H. 583.

tion,¹ for where detriment has been caused to the promisee, it is immaterial whether the promisor has been benefited or not; as, for instance, in the ordinary case of a guaranty the promisor is not benefited, but the promisee acting upon the promise, in lending money or performing services, suffers detriment in legal intendment. As a usual thing, where detriment has been caused to the promisee, benefit will have accrued to the promisor; but it is nevertheless to the detriment caused that we must look, as that is always sufficient to constitute a valid consideration.² Moreover, the consideration is presumed equal to the promise made therefor; and, however unequal in reality these two may be, the law will take no notice of their inequality, unless the inadequacy of the consideration is such as to raise a presumption of unfair advantage or fraud.³

§ 93. Let us now apply these principles to an agreement to take shares in the stock of a corporation to be organized. If the agreement to take shares is entered into by all the parties at the same time, it would, at least if drawn so that the parties purported to agree with each other, usually contain an ample consideration, the consideration for the promise of A. being the detriment caused B., C., D., etc., the other parties, in promising to take shares, the simple act of signing⁴ such an agreement being sufficient detriment caused to support a promise. It may be said further that the detriment caused B., C., D., etc., in

¹ See Langdell's Summary of the Law of Contracts, § 55.

² It has been the writer's opinion that benefit received at the time of making the promise is also a good consideration, whether detriment be caused to the promisee or not; that is, whether or not the consideration *move from* the promisee. But this is not universally accepted as law. See 2 Wharton on Contracts, § 784 *et seq.*, and an article by the writer in the April, 1881, number of the American Law Review on "The Right of a Third Person to Sue on a Contract made in his Favor."

³ There is an exception to the rule stated in the text. Where the promise

is to pay money absolutely, and the consideration is money given, the law will take notice of inequality between the consideration and the promise; and, therefore, money paid will not support a promise to pay more than the same sum with interest. See Langdell's Summary, etc., § 55. A court of equity, moreover, will sometimes regard the actual adequacy of consideration in deciding whether or not to decree the specific performance of a contract.

⁴ See *Haigh v. Brooks*, 10 Ad. & El. 309, 323; *Brooks v. Ball*, 18 Johns. 337.

promising to take shares, or in merely signing an agreement, is ample consideration to support the promise of A., irrespective of the question whether the promises of B., C., D., etc., in themselves considered, are valid promises or not.¹ In other words, where it is expressly stipulated in the agreement, or where, from the tenor of the same, it may appear, that the making of the mutual or respective promises contained in the agreement is to constitute the consideration for the agreement, it will not be the fact that the promises when made are enforceable, but the *making* of them which will constitute the consideration; though it follows that the promises when made will be binding, because founded on a valid consideration.

The question, then, will be, in any given instance, was the consideration of the promise of A. the making of the promises by B., C., D., etc., or the performance of their promises by the latter. In the former case the agreement is as clearly binding as in the latter case it is, in itself considered, worthless; because, until the promises of B., C., D., etc., have been performed, there is no consideration for the promise of A., which, therefore, until such performance, is in legal contemplation nothing more than an offer, which may be withdrawn at any moment. Through performance, however, on the part of B., C., D., etc., the promise of A. may become binding. For instance, the corporation having been formed, and A., not having in the mean time withdrawn from the agreement, if B., C., D., etc., take and pay for their shares as agreed, they (or the corporation, if it shall appear to have been the intention that the corporation should have the right to enforce the promise²) can then force A. to take and pay for his shares as well; for if relying on

¹ It is, of course, quite possible for an agreement of this kind to be drawn so as to be little more than worthless; *e. g.*, the promise of each might be made conditional on the actual taking of the shares by the others. Here, plainly, there is no binding contract. Such an invalid instrument would be the following: "It is mutually covenanted and agreed by and between the

parties hereto, that each of the said parties will take five shares in the stock of the X. Co. when organized, in consideration of each of the other parties hereto taking five shares," etc. This form might be binding were it not for the words "in consideration," etc.

² See *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546.

A.'s promise or, more strictly speaking, unwithdrawn offer,¹ to take shares, B., C., D., etc., have actually taken shares themselves, they have thereby accepted A.'s unwithdrawn offer, by performing that act, which was intended to be, when performed, a valid consideration, which should convert A.'s unwithdrawn offer into a binding promise; and in truth, therefore, they have thus transformed A.'s unwithdrawn offer into a binding promise, the performance of which may be enforced by the parties who have themselves performed, or by the corporation if such was the intention.²

§ 94. The foregoing discussion has proceeded on the assumption that the agreement to take shares was entered into by all the parties thereto at the same time; that it was, properly speaking, one agreement. Where, however, as is frequently the case, a subscription agreement is signed by different persons at different times, or where "books are opened for subscribers," who subscribe at different times, the foregoing remarks will be hardly applicable. For instance, in the case above conceived, where the making of the respective promises was plainly intended to be the consideration of the agreement, if we suppose that A., B., and C. sign together, and that some days afterwards D. signs, while A., B., and C. may be bound, as yet to D., if the consideration of his promise was the making of the promise of A., B., and C., it will be but a past consideration.

It might be said that all parties are to be presumed to sign at the same time; but when several days intervene between the times of actual signing, and especially where dates are annexed to the different signatures, such a presumption becomes too glaringly contrary to fact to exist even in legal contemplation. In such a case further consideration should be found for D.'s promise. Here, as we must presume all the parties to act

¹ This unwithdrawn offer is not even a conditional promise, because it may be withdrawn at any time before the performance of the consideration; and a true conditional promise may not be withdrawn, because founded on a consideration when made; although it may not be enforced until the condition has been performed.

² If the paper were so drawn that the consideration of each promise was the performance of *all* the other promises, the paper would practically amount to very little; as it would not become enforceable against any one subscriber until all the rest had voluntarily taken their shares.

in good faith and to wish to join in a valid agreement, the question would be merely as to the form of the same. Therefore, some consideration should be expressed to pass to D. from the other parties to the instrument at the time of his executing it. To this end, each promise could be expressed to be made in consideration of the making of the other promises, made or to be made, and of one dollar paid by some party on behalf of all present and future parties to the agreement, to the promisor at the time of his executing the same; which, for greater security, should be under seal.¹

§ 95. It may be added in passing, that if any of the parties to the instrument are infants, their promises will not be binding on them, unless ratified by them after coming of age;² and that if the object of incorporation, as expressed in the agreement, is illegal, the agreement to take shares will bind no one.

§ 96. When there are conditions in an agreement to take shares in a corporation to be formed, the instrument is to be construed with reference to them, so as to give them due effect.³ Moreover, in construing such conditional agreements, it must be noticed closely whether the condition relates to the promise or to the performance of the promise. If the promise of one party is made conditional upon the making of the promises by the other parties, such promise becomes absolute as soon as the other promises are made. But if a promise is made conditional upon the performance of the other promises, such a condition, as before pointed out, would go far towards making the whole agreement nugatory.⁴

The usual condition in an agreement to take shares in a cor-

¹ It will be noticed that cases like *Methodist Episcopal Church v. Kendall*, 121 Mass. 528, and other cases cited in the same note with it to § 92, were mostly cases of "gratuitous" subscriptions, made to promote some object in which the subscribers had no direct pecuniary interest. Such cases, therefore, are of questionable application in discussing the binding force of

subscriptions made to further some private money-making business scheme of the subscribers. Compare *Haskell v. Sells*, 14 Mo. App. 91.

² See *Lumsden's Case*, L. R. 4 Ch. 31; and *Reaveley's Case*, 1 De Gex & Sm. 550.

³ See *North Stafford Steel, etc., Co. v. Ward*, L. R. 3 Ex. 172.

⁴ See § 93.

poration to be formed is that the promises shall not be enforced until all or a certain amount of the stock of the future company is agreed to be taken.¹ Such a condition would be more apt to be present where the parties to the agreement sign at different times; in which case, as before pointed out, a consideration should be expressed to move from the representatives of all other parties to each party upon his signing the instrument. If this were done the promises would be binding conditionally as soon as made; and upon the fulfilment of the condition, that is, upon promises to take the requisite number of shares being made, they would become absolute. Should this condition, however, relate to the performance of the promises, the promises might amount to no more than offers, which could be withdrawn at any time before the fulfilment of the condition, for it may be said that until then they never had any even conditionally binding quality, except as above pointed out.²

§ 97. If the condition be one to be performed by the corporation when organized, then generally the agreement to subscribe made prior to its organization cannot be enforced before the

¹ When the amount of the capital stock is inserted in the subscription agreement, subscribers may refuse to pay any part of their subscriptions until the full amount is subscribed for. *Cabot & West Springfield Bridge v. Chapin*, 6 Cush. 50; *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23. See *Norwich, etc., Navigation Co. v. Theobald*, 1 Moo. & M. 151; *Waterford, etc., R. Co. v. Dalbiac*, 6 Ex. 443; *Penobscot R. R. Co. v. Dummer*, 40 Me. 172; *Penobscot, etc., R. R. Co. v. Bartlett* 12 Gray, 244; *Burt v. Farrar*, 24 Barb. 518; *Hughes v. M'f'g Co.*, 34 Md. 316; *Boston, Barre, etc. R. R. Co. v. Wellington*, 113 Mass. 79; *Erie, etc. R. R. v. Owen*, 32 Barb. 616; *Pierce v. Jersey Water Works Co.*, L. R. 5 Ex. 209; *Elder v. New Zealand Land Improvement Co.*, 30 L. T. N. S. 285; but see *Renssellaer, etc., Plank*

Road Co. v. Wetzel, 21 Barb. 56; *McDougall v. Jersey Imperial Hotel Co.*, 10 Jur. N. S. 1043. See §§ 517-521.

The prospectus of a company to be formed stated that the proposed capital stock was to consist of ten thousand shares of twenty-five pounds each. Only fourteen hundred of these shares were taken. Held, that the agreement of a person subscribing for shares was conditional on the fulfilment of the terms of the prospectus. *Pitchford v. Davis*, 5 Mees. & W. 2. This case may give rise to the quære whether it is proper to construe all the terms of the prospectus as conditions in the agreement to take shares. Still, *Fox v. Clifton*, 6 Bing. 779, accords; but see *Hutt v. Giles*, 12 Mees. & W. 492.

² See § 93.

performance of the condition,¹ unless it is the promisors themselves who, as a matter of fact, prevent the fulfilment of the condition in order to invalidate their own promises.² In the last case the promisor who is concerned in preventing the fulfilment of the condition may take no advantage of its non-fulfilment; and this on general principles of good faith and equity, and in accordance with the law relating to the performance of conditions generally.³

§ 98. It may be said, as incidental to the preceding discussion, that where a number of persons intending to form a corpora-

¹ Effect should be given to conditions in a letter accepting a position as provisional committee-man, and agreeing to take shares. *Roberts's Case*, 3 De Gex & S. 205; affirmed, 2 Mac. & G. 192; see *Wood's Case*, 3 De G. & J. 85; *Burrows v. Smith*, 10 N. Y. 550; *Union Hotel Co. v. Hersee*, 15 Hun, 371. It has been held, where persons acting as agents for a contemplated turnpike company, obtain subscriptions on certain conditions as to the location of the road, that the corporation cannot afterwards recover on those subscriptions, without complying with the conditions; and that on the definite failure of the corporation to comply with them, payments already made may be recovered back. *Frankfort and Shelbyville Turnpike Co. v. Churchill*, 6 T. B. Monroe (Ky.), 427. The agreement in this case was separate from the subscription, but was formally drawn in writing, and contained a covenant to return the moneys received, unless the road was run as agreed.

On the other hand, it has also been held, where a general turnpike act conferred no power on the commissioners to accept conditional subscriptions, that a subscription conditioned on the laying of the road through a

specified place is contrary to public policy and void. *Butternuts, etc., Turnpike Co. v. North*, 1 Hill, 518; *Fort Edward, etc., Plank Road Co. v. Payne*, 15 N. Y. 583. Parol declarations made by officers of the company can only avail a subscriber seeking to invalidate his subscription for shares where they amount to fraud. *Vicksburg, etc., R. R. Co. v. McKean*, 12 La. Ann. 638; *Martin v. Pensacola, etc., R. R. Co.*, 8 Fla. 370; *Mississippi, etc., R. R. Co. v. Cross*, 20 Ark. 443. So parol declarations made by promoters as to route, will not, unless they amount to fraud, avail the subscriber. *Braddock v. Philadelphia M. & M. R. R. Co.*, 45 N. J. L. 363. And parol agreements made at the time of subscribing for shares, and inconsistent with the written terms of the subscription, are void. *Connecticut and Passumpsic Rivers R. R. Co. v. Bailey*, 24 Vt. 465; *Whitehall, etc. R. R. Co. v. Myers*, 16 Abb. Pr. (N. S.) 34; *Haskell v. Sells*, 14 Mo. App. 91; *Galena & S. W. R. R. Co. v. Ennor*, 116 Ill. 55. See § 521.

² See *Upton v. Hansbrough*, 3 Bissell, 417, 423.

³ See *Raynay v. Alexander*, Yelv. 66; *Hotham v. East India Co.*, 1 T. R. 638.

tion, and through that means carry on some business, raise a common fund, eventually to be increased, but beginning with deposits placed in the hands of a committee with authority to do certain acts, it is not competent for any one of such subscribers to withdraw his funds so deposited, until it has become evident that the carrying out of the scheme is impracticable.¹

When deposits may be withdrawn.

§ 99. If a person agrees to pay a deposit, and the consideration of that agreement fails, he need not perform;² but, nevertheless, should he agree to pay deposits by a certain day, he cannot plead to an action for not paying them on or before that day that the projected company has become abortive since that day; for that might not have happened had he paid his deposits as agreed, and circumstances intervening after he broke his promise are no excuse for such breach.³ Where, however, a person subscribes for stock in a future corporation, as the contract does not purport to be with an existing corporation, the subscriber is not estopped, in a suit to enforce his subscription, from denying that the corporation ever came into existence.⁴

Certain defences.

§ 100. Having considered the general question of the validity and construction of an agreement to take shares in the stock of a future corporation, there remain for consideration the legal relations arising from such an agreement. *Prima facie* these relations are such as may be inferred from the terms of the instrument; for the courts ordinarily, as among the parties to the instrument, will enforce its provisions according to their tenor and import. Such agreements differ much from each other. One might readily be drawn so as to constitute the parties thereto partners, at least in regard to the scheme of incorpora-

Legal relations arising from a valid agreement to take shares.

¹ Baird v. Ross, 2 Macqueen, 51; compare Kent v. Jackson, 14 Beav. 367; Kidwelly Canal Co. v. Raby, 2 Price, 93.

² See Duke v. Andrews, 2 Ex. 290.

³ Duke v. Dire, 1 Ex. 36; Oldham

v. Brown, 7 Ellis & B. 163; S. C., 2 Ellis & E. 398.

⁴ Rikhoff v. Brown's Sewing Machine Co., 68 Ind. 388; Indianapolis Furnace, etc. Co. v. Herkimer, 46 Ind. 142; see Reed v. Richmond Street R. R. Co., 50 Ind. 342; §§ 537, 538.

tion; as, for example, if the instrument should provide that the parties thereto should act as each other's agents in the furtherance of the scheme, and share any profits or losses arising before the incorporation of the company. Such provision, however, would ordinarily be absent, and by merely entering into a binding agreement to take shares in a corporation to be formed, persons do not become partners, nor liable as principals for each other's acts as agents.¹

To be sure, after the agreement is executed, supposing it to be a mere agreement to take shares, the parties thereto may so act that outsiders are justified in concluding that the relationship of principal and agent or of partners exists among them; and this on principles before discussed in relation to promoters.² Therefore, while in fact, as among themselves, no relationship of agency or partnership exists, they may be held responsible to outsiders for the acts of each other, either as principals or as partners, according to the circumstances.

§ 101. To what extent a party to an agreement to take shares in the stock of a corporation to be formed may, by assigning his interest in the agreement, relieve himself from future liability, will depend on a proper construction of the instrument itself, qualified by the general maxim, that while a man may assign or waive any rights accruing to him under an agreement, he cannot divest himself of his liabilities arising therefrom.³ It would be most unjust to hold, where responsible persons have joined in an agreement to furnish funds for the advancement of a scheme of incorporation, and to take shares in the stock of the future company, that under such circumstances any one of them may avoid fulfilling his contract, by assigning his interest to some irresponsible person. It must be admitted, however, that under somewhat analogous circumstances the English cases hold that a shareholder, even in a company of unlimited liability, may free himself from any future liability by transferring

¹ *Shibley v. Angle*, 37 N. Y. 626.
See *Fay v. Noble*, 7 Cush. 188.
Thrasher v. Pike Connty R. Co., 25 Ill. 393; and compare *Garnett v. Richardson*, 35 Ark. 144.

² See § 77.

³ *Graff v. Pittsburgh and Steubenville R. Co.*, 31 Pa. St. 489.

his shares to a man of straw for that very purpose, provided the transfer be absolute.¹ The American law is different on this point.²

§ 102. Moreover, by assigning his interest in a contract to take shares in the stock of a future corporation, a person may incur liability to his assignee, at least if he purports to *sell shares* in the stock of a future corporation,³ for, should such a corporation never be organized, he might have to refund any money paid him by his vendee. Still, in the absence of fraud, the vendor would incur no liability to his vendee by selling him merely his right to shares in the stock of the corporation when formed; for here there is no failure of consideration even though the corporation be never formed, because the vendor sold only his right to shares in the stock of a certain corporation should it thereafter be organized.

§ 103. Persons agreeing to take shares in the stock of a corporation to be formed necessarily come in contact with the promoters of the scheme of incorporation; they usually subscribe on the faith of the acts and representations of the latter, and judge as to the ultimate success of the undertaking from the opinion they have formed of its promoters. The promoters of the plan are in a better position to judge of the feasibility and desirableness of the scheme than are persons who merely agree to take shares in the concern when it shall have started. Because of these and similar considerations a fiduciary relationship arises between the promoters and persons who agree to subscribe for shares in the stock of the future corporation;⁴ and the latter are in consequence entitled to fair and open treatment from the former. It follows that promoters are liable to persons who subscribe for shares in the stock of the future company for damages caused by any fraudulent misrepresentation or concealment on their part, where the subscribers have relied on their

Legal relations between subscribers and promoters.

¹ Jessop's Case, 2 De G. & J. 638; 152; Marcy v. Clark, 17 Mass. 330. DePass's Case, 4 De G. & J. 544; See §§ 586, 749.

Harrison's Case, L. R. 6 Ch. 286; ³ Kempson v. Saunders, 4 Bing. 5. Williams's Case, 1 Ch. D. 546. See Street v. Bailis, 2 P. Wms. 217.

§§ 586, 749. ⁴ Williams v. Page, 24 Beav. 654,

² Nathan v. Whitlock, 9 Paige, 661.

representations,¹ and to recover such damages the subscriber can bring an action in law for deceit,² and may have a right in equity to have his subscription cancelled,³ provided by such cancellation the rights of other and innocent persons are not infringed. Promoters may also be responsible to subscribers for the misrepresentations of their fellow-promoters, if the relationship of agency or partnership existed between the promoters; or if they had acted in a way to justify subscribers in inferring the existence between them of either of these relationships.⁴

§ 104. That, upon the failure of the scheme of incorporation,

subscribers may recover back from the promoters deposits paid on subscribing for shares in the contemplated corporation, is a proposition which is not always true. In such a case the rights of the subscriber who has paid the deposit depend on the intention and meaning of the parties to the scheme, as expressed in the subscription agreement and viewed in the light of surrounding circumstances.⁵ If, judging of the matter in this way, it appears to have been the intention that the deposits should be applied to the furtherance of the scheme, then, although the scheme proved abortive, the moneys will have been applied to the purpose for which they were presumably destined;⁶ and the subscribers can recover back only such moneys as either have not been expended and so remain in the hands of the promoters, or such as have been spent by the promoters after all reasonable hope for the success of the undertaking had passed away, and under such circumstances as to imply wilful mismanagement or fraud on their part.⁷ But fraud on the part of the promoters

¹ *Hornblower v. Crandall*, 7 Mo. App. 220; aff'd 78 Mo. 581.

² *Paddock v. Fletcher*, 42 Vt. 389; *Gerhard v. Bates*, 2 El. & B. 476. See *Twycross v. Grant*, 2 C. P. Div. 469.

³ *Kent v. Freehold Land Co.*, L. R. 4 Eq. 588. An innocent misrepresentation, in order to release the subscriber, must extend to the fundamental nature of the enterprise. *Kennedy v. Panama, etc. Mail Co.*, L. R. 2 Q. B. 580.

⁴ *Hornblower v. Crandall*, 7 Mo. 220; aff'd 78 Mo. 581.

⁵ See *Moore v. Garwood*, 4 Ex. 681.

⁶ *Garwood v. Ede*, 1 Ex. 264; *Clements v. Todd*, 1 Ex. 286; *Jones v. Harrison*, 2 Ex. 52; *Willey v. Parratt*, 3 Ex. 209.

⁷ *Watts v. Salter*, 10 C. B. 477. See *Ship v. Crosskill*, L. R. 10 Eq. 73; and compare *Vane v. Cobbold*, 1 Ex. 798; *Watson v. Charlemont*, 10 Q. B. 856.

in procuring the deposits would change the situation and entitle the depositors to recover back the whole amount, at least as between them and the fraudulent promoters.¹

If, however, the deposits were made merely in order to comply with some resolution or statutory requirement, and without any intention on the part of the subscribers, or right on the part of the promoters, to apply the money in furthering the organization of the company, then the subscribers would be entitled to have their entire deposits returned.² Under such circumstances, whether the promoters would be accountable for deposits received by others of their number must be decided according to principles already often referred to;³ generally they would not be.⁴

§ 105. It goes without saying that whoever agrees to take shares in the stock of a future corporation, merely in order that others may be induced to agree as well, Fraudulent
subscriptions. having a secret understanding with the promoters of the scheme that no liabilities shall attach themselves to him by reason of his contract, will be bound to fulfil the letter of his agreement, at least in so far as the non-fulfilment thereof would injure innocent persons who have acted on the faith of it.⁵ And, moreover, in so far as the promoters carry out this fraudulent secret understanding will they render themselves personally liable to persons defrauded and injured thereby.⁶

§ 106. One thing further as to the relationship between the

¹ See *Colt v. Woolaston*, 2 P. Wms. 153; *Twycross v. Grant*, 2 C. P. Div. 469. But one subscriber, whose subscription has been obtained through the fraudulent representations of a promoter, cannot maintain an action for money had and received against other subscribers who are not implicated in the fraud. *Perry v. Hale*, 143 Mass. 540.

² *Nockels v. Crosby*, 3 Barn. & Cr. 814; *Ashpittel v. Sercombe*, 5 Ex. 147. So if directors (promoters) undertake to return deposits without deduction in case the scheme proves abortive, as for instance, through failure to obtain an

act of parliament, they will be liable personally. *Ward v. Londesborough*, 12 C. B. 252.

³ See *Walstab v. Spotteswood*, 15 M. & W. 501.

⁴ See *Burnside v. Dayrell*, 3 Ex. 224, commented on in Thompson on the "Liabilities of Agents of Corporation," p. 215.

⁵ *White Mountains R. R. Co. v. Eastman*, 34 N. H. 134; *Custar v. Titusville Gas Co.*, 63 Pa. St. 381. See *Litchfield Bank v. Church*, 29 Conn. 137.

⁶ See *Hall's Case*, L. R. 5 Ch. 707; *Getty v. Devlin*, 70 N. Y. 504.

promoters, and persons agreeing to take shares and making deposits. Such persons enter into such an agreement and pay their preliminary deposits, expecting that a corporation, with the nature and general purposes of which they have been made acquainted by the prospectus and representations of the promoters, will be organized; and they have contracted and paid their money with this special scheme in view. Clearly, if the promoters apply the funds so deposited in any other way than that which the subscribers were justified in contemplating, the subscribers' moneys have been misapplied, and each of them has a plain claim to recover back such funds from any promoter responsible for their misapplication. Such a misapplication would be a conversion of the funds of the subscribers, for which wrong an appropriate action would lie. It would seem, moreover, that any depositor should have a remedy, not only to obtain damages from the promoters for any misapplication of deposits, but, in cases where justice could not otherwise be done; that a depositor might compel the promoters to apply such funds to the furtherance of the scheme for which they were subscribed, at least so far as it would be practicable for a court of equity to enforce such application.

§ 107. We come now to the relations between a person who has agreed to take shares in the stock of the future corporation, and that corporation itself when organized.

Subscriptions generally enforceable by the corporation when organized.

§ 108. First, in regard to enforcing the agreement to subscribe for shares. This was an agreement between the parties thereto to do a certain thing, to wit, to subscribe for shares in the stock of a certain corporation when organized; that is, it was an agreement to invest a certain amount of capital in a certain manner, to be used for a certain purpose. If we regard the corporation when formed as a distinct person, a legal difficulty will at once arise. This "person" was not a party to the agreement, did not even exist at the time when the agreement was made, what standing has it in court to compel the performance of the agreement?¹

¹ "A subscription to take shares in the stock of a corporation to be formed enures to the benefit of that corporation when formed." *Griswold v. Peo-*

But this difficulty is entirely gratuitous, and arises only from the conception of a company as an entity, which at the very moment of the completion of its organization and *thereby* becomes a "person" distinct from all persons interested in the corporate enterprise. If we regard the company at the time of its incorporation merely as the aggregate of its members acting and bound to act in a certain way, and to employ certain funds in a certain manner for a certain purpose,¹ all difficulty will be avoided; and we shall then have the contract enforced by the parties thereto, acting in precisely the manner contemplated, to wit, as a corporation, through the medium of corporate machinery and organization. By means of this natural conception all difficulty is avoided, and no violence is done to the strictest requirements of logical or legal thought.

§ 109. Accordingly, the proposition may be regarded as law throughout the United States, that when several persons mutually agree to subscribe for shares in a corporation to be formed by the subscribers for the advancement of their interests, the

ria University, 26 Ill. 41; Cross v. Pinckneyville Mill Co., 17 Ill. 57; see Eastern Plank Road Co. v. Vaughan, 20 Barb. 155; S. C., 14 N. Y. 546; and Angell and Ames on Corp., § 523. The insolvency of the corporation is no ground to restrain the collection of subscriptions to its stock. Dill v. Wabash Valley R. R. Co., 21 Ill. 91.

Penobscot, etc., R. R. Co. v. Dummer, 40 Me. 172, seems to hold an agreement to take shares in the stock of a future corporation, to be *as to the corporation a proposal*, which is bindingly accepted by the corporation when organized recognizing the shares so subscribed for as shares of its stock. See Thompson v. Page, 1 Metc. 565; Stanton v. Wilson, 2 Hill, 153; Kennebec, etc., R. R. Co. v. Palmer, 34 Me. 366; Gleaves v. Brick Church Turnpike Co., 1 Sneed (Tenn.), 491; Buffalo and Jamestown R. R. Co. v. Gifford, 87 N. Y. 294. Perhaps the

trouble with some of these cases is that the right of the corporation to sue is not well thought out. To say that the agreement enures to the benefit of the corporation when formed raises the question of the competency of a person not party to a contract, from whom no consideration moves, to sue thereon; which is greatly in dispute. To be sure the doctrines of ratification may be resorted to where the agreement to subscribe was entered into with persons authorized or purporting to act on behalf of the future company. See § 87.

¹ Persons may agree with each other as to the terms on which they will take stock in a corporation to be formed by them. Under our system the corporation following such an agreement would be the mere agency of the associates created for the sake of convenience in carrying out the bargain. Chater v. San Francisco Sugar Refining Co., 19 Cal. 219, 246.

corporation when organized may recognize the subscribers as shareholders, and enforce the subscriptions;¹ and especially is this true when the subscription-agreement is made with persons who by statute represent the future corporation for the purpose of receiving subscriptions.² If, however, the parties to the subscription agreement are not themselves the organizers of the corporation, and in no sense represent the future company, and are a different body of men from those composing the corporation when formed, then is certainly raised the difficult question of the right of a third person to sue on a contract.³

§ 110. It remains to consider the rights of the parties to the original agreement as against the corporation. If the corporation when organized is composed of the subscribers, or if the agreement to subscribe is made with persons who by statute represent the corporation while it is being organized, a subscriber acquires* by his agreement the right to have the shares subscribed for by him allotted to him, unless his subscription is made after the full

¹ *Buffalo and Jamestown R. R. Co. v. Clark*, 22 Hun, 359; *aff'd* 87 N. Y. 632; *Twin Creek, etc., Turnpike Co. v. Lancaster*, 79 Ky. 552; *Boot & Shoe Co. v. Hoit*, 56 N. H. 548; *Tonica, etc., R. R. Co. v. McNeely*, 21 Ill. 71; *Johnston v. Ewing Female University*, 35 Ill. 518; *Red Wing Hotel Co. v. Friedrich*, 26 Minn. 112; *Whitsitt v. Presbyterian Church*, 110 Ill. 125; *Haskell v. Sells*, 14 Mo. App. 91. See *Peninsular Ry. Co. v. Duncan*, 28 Mich. 130, 134, and authorities cited in note 1 to § 91. Compare *Burt v. Farrer*, 24 Barb. 518; *Howe v. Flagg*, 72 Ill. 397; *Marseilles Land Co. v. Aldrich*, 86 Ill. 504, and the cases cited in notes to § 91.

² *Delaware and Atlantic R. R. Co. v. Irick*, 23 N. J. L. 321; *Hughes v. M'fg Co.*, 34 Md. 316.

³ See *Lake Ontario Shore R. R. Co. v. Curtiss*, 80 N. Y. 219, where

defendant and others signed the following instrument: "We, the undersigned, citizens of Unionville and vicinity, pledge ourselves to subscribe for and take stock in and for the construction of the Lake Ontario Shore R. R. Co., to the amount set opposite our names respectively, on condition said road be located and built through or north of the village of Unionville." The railroad was built so that it fulfilled the condition above, but it was held that this agreement did not amount to a subscription to plaintiff's stock, and that, being no party to the agreement, the plaintiff could maintain no action on it. See also *California Sugar M'fg Co. v. Schafer*, 57 Cal. 396; *Strasburg R. R. Co. v. Echternacht*, 21 Pa. St. 220. Compare *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546, 555.

amount of the capital stock authorized by the charter of the corporation is subscribed for.¹

It will be remembered that all the parties to the subscription agreement have agreed to invest certain funds for the accomplishment of a certain object, and that these funds should be managed and applied for the furtherance of that object through the medium of corporate organization; suppose that this agreement is violated, either through the managers of the scheme procuring a charter different from the one contemplated, or by their actually misapplying funds already contributed; that is, applying them in a manner and for purposes other than those contemplated by the original agreement. In other words, it becomes apparent that the purposes for which the corporation is actually being organized differ from those justifiably contemplated; that another scheme, differing from the original plan, is being gone into. It is plain that any one of the original parties or his representatives, can say, "I never paid deposits to be used for any such purpose." And it is further evident, that, as between him and any body or individual acting in violation of the terms of the original agreement, he may claim to be released from his contract, and perhaps to have moneys paid or expended by him reimbursed. Thus, as between a party to the original agreement to take shares and the corporation when organized, any material divergence of the corporate scheme from the plan justifiably contemplated by a party to the agreement to take shares at the time of his signing the same, or paying deposits in accordance therewith, will release him from his contract, and may entitle him to recover any moneys paid or expended by him in pursuance of its terms.²

¹ This right of the subscriber constitutes in the main the consideration by virtue of which the corporation may enforce his subscription; see notes to § 91, and cases in last three notes. See generally §§ 515, 516.

² "A person who agrees to take shares in a company formed for a given purpose and with a given capital, is not bound to accept shares in

a company formed for another purpose or with a different capital; and it follows from this that a material variation from the original scheme, if unassented to by a subscriber to it, affords an answer to any application for calls which may be made upon him." 2 Lindley on Part., 625, citing *Galvanized Iron Co. v. Westoby*, 8 Ex. 17. See *Rye's Case*,

If the divergence alluded to is immaterial, or such as was contemplated in the original agreement as a possibility (*i. e.*, no divergence at all); or if a party has acquiesced in the divergence, which may be implied from long-continued neglect to repudiate, he will not be released from his agreement to take shares.¹ But usually from mere lapse of time, unless very great, acquiescence cannot be inferred; there must be some reason to infer knowledge on the part of the dissenting party of the violation, and neglect to repudiate after that knowledge had been obtained.²

§ 111. The qualification, "as between the party to the agreement and the corporation when organized," is to be noted; for, should such a party refrain from enforcing his rights for any considerable length of time, the corporation, or the other shareholders or subscribers, might claim that he had waived his rights, or at least was estopped from asserting them to the injury of any one who had reasonably acted on the supposition, occasioned by the delay, that he had waived them. And should the rights of any outsiders who had contracted with and become creditors of the corporation intervene, the subscribers should certainly not be allowed to withdraw funds or claim a release from their agreements to the detriment of persons outside the corporation, who very likely contracted with the corporation on the credit of those funds or agreements to subscribe. Such outside creditors could well say that the original contracting parties, in entering on such an

3 Jur. N. S. 460; *Ship's Case*, 2 De G., J. & Sm. 544; *Stewart's Case*, L. R. 1 Ch. 574; *Webster's Case*, L. R. 2 Eq. 741.

¹ *London, etc., Assurance Soc. v. Redgrave*, 4 C. B. N. S. 524. "But if a subscriber to a company binds himself to take shares in a company which may differ more or less from that originally proposed to be formed, he cannot set up a variation in the original scheme as an answer to a demand for payment of the capital he has undertaken to contribute." 2 Lindley on

Part., 625. See *Midland, etc., R. Co. v. Gordon*, 16 M. & W. 803; *Nixon v. Brownlow*, 2 H. & N. 455; S. C., 3 H. & N. 686; *Norman v. Mitchell*, 5 De G., M. & G. 648.

² See cases cited in last note but one, and *Nichol's Case*, 2 W. N. 77; *Bailey's Case*, L. R. 3 Ch. 592. The repudiation was held too late in *Lawrence's Case*, L. R. 2 Ch. 412; *Brigg's Case*, L. R. 1 Eq. 483; *Whitehouse's Case*, L. R. 3 Eq. 790; *Taite's Case*, L. R. 3 Eq. 795.

enterprise, took upon themselves, at least as regards outsiders acting in good faith, the risk of internal mismanagement of the affairs of the corporation and misapplication of its funds. So it behooves a dissenting party or subscriber to dissent actively at once, and better before than after the organization of the corporation; and if after, then at the earliest possible moment.

§ 112. It may be added, finally, that not only may a party acting promptly claim a rescission of the contract, but a court of equity will ordinarily aid him with an injunction, restraining the other parties to the contract or the corporation from acting in violation of his rights.¹

¹ See Lord Eldon's valuable judgments in *Natusch v. Irving*, Gow on 1830), and in *Coust v. Harris*, Turn. & R. 496. Compare *Stocker v. Wedderburn*, 3 K. & J. 393. Part. App. 576 (American ed. of

CHAPTER VII.

LEGAL EFFECT OF ACTS DONE BY OR ON BEHALF OF A CORPORATION.

Explanation of terms : “ Legal effect,”	Divergency of interests, §§ 116, 117.
§ 113.	All persons may look to the corporate constitution, § 118.
“ Corporate powers,” § 114.	Purpose of this chapter, § 119.
Considerations regarding them, § 115.	

PRELIMINARY.

§ 113. It has been shown in a previous chapter¹ that a corporation, regarded as a legal institution, is the sum of the legal relations in which the rules of law contained in the constitution of the corporation manifest themselves, and which subsist between the state, the shareholders, the officers, and the creditors of the corporation in respect to the corporate enterprise, and mainly in respect to the corporate funds. It was also pointed out, that the term corporation has another and distinct meaning; *i. e.*, the body of men and their successors whose acts caused incorporation, and who thereby became a corporation or body corporate. Accordingly, by the phrase “legal effect of acts done by or on behalf of a corporation,” are meant the legal relations which acts done by or on behalf of this body corporate occasion.²

§ 114. As the phrase “corporate powers” will often be used in this chapter, to explain what will be meant by it is not out of place. By the contract embodied in the constitution of the corporation, the corporators³

¹ Chapter III.

² See § 445.

³ The term “corporators,” as here used, is intended to signify the original body of subscribers or shareholders who take part in the organization of

the corporation. The term, however, as used in some enabling acts, denotes the persons who execute the certificate of incorporation, and thereby become a body corporate. Such persons, it seems, need not themselves be share-

agree under the express sanction of the state, that the corporate enterprise shall be organized and managed in a certain manner, and that the highest authority in regard to the corporate affairs shall be vested in certain persons. These persons usually are a majority¹ of the incorporators themselves, and the way in which they ordinarily act is by a vote in a duly summoned meeting of the body corporate. This majority elect directors, whose authority when elected to represent the corporation is either derived directly from the constitution, or is bestowed by the vote of the majority of shareholders. In the original contract, or in the constitution in which it is embodied, the object of incorporation and the means of attaining it are specified; and this specification indicates the extent of discretion and power competently² conferred by all the incorporators acting as individuals, on themselves as a body corporate, or on the board of directors.

The corporate powers, then, are the powers of the corporation or body corporate to act as such; and are to be deduced from the object of incorporation and the means of attaining it authorized by the constitution of the corporation.³ Conse-

holders. See, *e. g.*, the New York Manufacturing Companies Act of 1848. "Corporators," in this latter sense, acting in pursuance of some enabling act, decide on the object of incorporation, and start the corporation. Shareholders, who are not of their number, by taking shares in the stock of the corporation, assent to the acts of the incorporators. The gist of the matter lies herein: that whether or not the main body of shareholders take part in organizing the corporation, they ratify its organization by becoming shareholders; and agree to be bound by the provisions of the certificate of incorporation and by those of the enabling act in pursuance of which the certificate is executed and filed.

¹ *I. e.*, a majority "in interest;" those holding a majority of shares; which will be intended hereafter when

a "majority of shareholders" is spoken of.

² *I. e.*, with the sanction of law.

³ The purposes of incorporation are always important in determining the scope of the corporate powers. Thus a corporation may purchase an invention tending to facilitate the purposes of its incorporation as indicated by the corporate name. *Dorsey Harvester Rake Co. v. Marsh*, 6 Fish Pat. Cas. 387. Again, it may be properly within the powers of a corporation running an iron furnace, to have a supply store. *Searight v. Payne*, 6 Lea (Tenn.), 283. And a corporation may employ an agent to perform services consonant to its general design, without any specific authority to do so. *Kitchen v. Cape Girardeau, etc.*, R. R. Co., 59 Mo. 514. See also *Spangler v. Butterfield*, 6 Col. 356, 364. In

quently, whether a. given act is within the corporate powers, depends on whether it is an act authorized by the constitution to be done for the attainment of the object of incorporation.¹

§ 115. It is not merely for the convenience of the corporators that the state, by giving the force of law to the contract between the corporators, sanctions the corporate powers. In the creation or recognition of every rule of law in the constitution of a corporation, and consequently of every rule the function of which is to regulate the corporate powers, the state has continually in view the security of persons dealing with the corporation, as well as the welfare of the public so far as the public may be interested in the object of incorporation. The contract embodied in the constitution is a contract made with the intention that persons other than the contracting parties shall act relying on its terms.² Indeed many of the provisions of this contract, which through incorporation become rules of law, are evidently such as will manifest themselves in the rights of persons other than shareholders. Accordingly, every one will have a right, corresponding to his interests in the corporate enterprise, to insist on a proper exercise of the corporate powers, and to restrain the corporation from improper and *ultra vires* action.

Bank v. Flour Co., 41 O. St. 552, the court reasoned thus: In determining whether an act is within the powers of a corporation, regard is to be had to its effect and the real object in view; *e. g.*, though a corporation may not ordinarily, unless specially authorized, make contracts of suretyship, yet it may guaranty a debt of its president to a third person when the real object sought is to secure its own indebtedness to him.

¹ It follows that a charter or enabling act of a corporation is in its general nature enabling and not restrictive; conferring powers which may be exercised, rather than enumerating those which may not be exercised.

Accordingly, where the charter or enabling act is silent in regard to any class of acts, the presumption will be that the corporation has no authority to do them, unless they are incidental to the exercise of the powers expressly granted. See *Thomas v. Railroad Co.*, 101 U. S. 71; *Head v. Providence Ins. Co.*, 2 Cranch, 127, 166; also §§ 120, 121.

² A corporation, organized pursuant to an agreement authorized by competent legislation, is bound by all the liabilities imposed by the agreement in favor of third persons. *Welsh v. First Div. St. Paul and Pac. R. R. Co.*, 25 Minn. 314.

§ 116. It must be borne in mind that the interests of some persons in the corporate enterprise will be opposed to the interests of others. While it is for the interests of shareholders that the corporate enterprise shall be managed so as to insure the continuing solvency of the corporation, it is also for their interests that dividends may be had from the business. The interests of creditors, on the other hand, are exclusively that the corporation shall continue able to pay the principal and interest of its indebtedness; so the interests of shareholders may readily conflict with those of creditors. Again, it is possible that the interests of the state, or the public at large, may be opposed to the interests of shareholders and creditors alike; and, in certain cases, where usually improper elements would be present, the interests of directors might diverge from those of the public, of shareholders, and of creditors. Finally, not only may the interests in the corporate enterprise of one class of persons be opposed to the interests of another class, but a divergency of interest may readily arise within the limits of a single class; as, for instance, when the corporate solvency is not assured, it will be for the interests of one set of creditors to oppose the payment of debts alleged to be due another set.

Divergency
of inter-
ests.

§ 117. In short, incorporation, and subsequent acts in respect to the corporate enterprise, give rise to a conflict of opposing interests and to complicated legal relations, all of which interests and relations must be regarded in applying the corporate funds. And to say that these funds must be managed with due regard to the interests of all, implies the further proposition that the managers of the corporate enterprise are accountable for the proper disposition of these funds to all persons interested, to the extent of the respective interests of such persons. In determining the legal relations arising from acts done by or on behalf of a corporation, the importance of bearing in mind that the legally protected interests of different persons in the corporate enterprise are distinguishable will be apparent throughout this chapter.

§ 118. In subscribing for shares, in managing the corporate enterprise, and in contracting on the credit of the corporate funds, everybody may rely on the constitution of the corpora-

tion; by which everybody interested in the corporate enterprise is bound, and with knowledge of which every one is affected.¹ Therefore, the acts of the body corporate done in accordance with this constitution, and the acts of directors and other corporate agents within the scope of their authority are valid² and binding³ on all persons. The management of the corporate enterprise in pursuance of the constitution of the corporation is the proper management by which every one is bound and to which no one can object.⁴

§ 119. The purpose of the present chapter is to give a view of the legal relations which acts done by or on behalf of a corporation occasion between the corporation (including all its shareholders and existing creditors) and the person dealing with it or its representative.

¹ See § 195.

² An act is valid when it occasions the apparently intended legal relations.

³ To say that the act of one person is binding on another, means that it occasions the legal relations which would have been occasioned had such other person done the act himself. It may

occasion legal relations affecting the persons doing it as well.

⁴ The propriety of acts may often depend on the condition of the corporate affairs. What would have been a lawful and proper use of the corporate funds when the corporation was solvent, may be both improper and unlawful when the corporation becomes insolvent.

PART I.

CONSTRUCTION OF CORPORATE POWERS.

General rules regarding corporate powers, § 120.	When a shareholder may sue on behalf of the corporation, § 139.
Corporate powers to be construed reasonably, § 121.	Shareholder must allege demand on the corporation to sue, §§ 140, 141.
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Power to raise money, § 123.	Service of process on corporations, § 143.
By issue of stock, § 124.	Effect of appointment of receiver, § 144.
By borrowing. Corporations may mortgage their property. Exceptions, § 125.	Corporate franchises cannot be questioned collaterally. General rule, § 145.
"Deferred income-bonds," § 126.	Scope of the rule when an estoppel affects the case, §§ 146-150.
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Power to hold land. Statutes of mortmain, § 128.	Defective organization remediable, § 157.
Power to acquire personal property, § 129.	Right to corporate name, § 158.
Power to alienate, § 130.	Effect of misnomer, § 159.
Power to transfer franchises, §§ 131, 132.	Powers of banking corporations, § 161.
Power to increase or decrease the capital stock, § 133.	Powers of railroad corporations. Eminent domain, §§ 162-164.
Power of a corporation to purchase its own stock, §§ 134, 135.	Rights of the corporation as to land acquired by eminent domain, § 165.
A corporation may reissue its shares purchased by it, but cannot vote on them, § 136.	Eminent domain not transferable, § 166.
Capacity of a corporation to sue, § 137.	
Suits must in general be brought in the name of the corporation, § 138.	

§ 120. GENERAL rules regarding the powers of corporations have often been laid down, both in text-books and in adjudicated cases. In regard to these rules themselves there is less difference of opinion than in regard to their application. In the first place corpora-

General rules regarding corporate powers.

tions ordinarily have still the common law capacities which were specified and discussed in Chapter II. Further, it is established as a universal rule that a corporation has the powers which are expressly granted to it by its constitution, as well as those powers which are incidental or necessary to the exercise of its express powers in attaining the objects of its incorporation. Consequently, whether a given act is within the powers of a corporation depends on the construction of its constitution. These questions of construction, however, are often difficult, as the constitution of a corporation may be obscure; and how a court will decide a question of the construction of corporate powers, may even depend on the temperament of the judges, and whether they are disposed towards a liberal construction, or consider it in general the wiser policy for the law to keep corporations well within the apparent scope of their powers.¹

Giving the opinion of the Supreme Court of the United States in *Thomas v. Railroad Co.*,² Justice Miller said: "We take the general doctrine to be in this country, though there may be exceptional cases and some authorities to the contrary, that the powers of corporations organized under legislative statutes are such and such only as those statutes confer."³ Conceding the rule applicable to all statutes, that what is fairly implied is as much granted as what is expressed, it remains that the charter of a corporation is the measure of its powers, and that the enumeration of these powers implies the exclusion of all others." Few cases consciously militate against this general statement.⁴

¹ The remark in the text is illustrated by the difference of opinion which for a century has raged about the meaning of the words "necessary and proper" as used in the Federal constitution; a difference of opinion which has often drawn the lines between political parties. Is a measure "necessary and proper" to carry out the powers of congress? The answer of most persons will depend partly on whether they think the measure a desirable one, and partly on whether

they believe in extending or narrowing the powers of the central government.

² 101 U. S., 71, 82.

³ In construing the powers of a corporation, reference is to be had, not only to its charter or enabling act, but to all statutes affecting the corporation. See *Relfe v. Rundle*, 103 U. S. 222; *Dorsey Harvester Rake Co. v. Marsh*, 6 Fish. Pat. Cas. 387.

⁴ "The charter of a corporation, read in connection with the general laws applicable to it, is the measure of its

§ 121. It is also pretty well established that charters and enabling statutes (except in so far as they purport to confer extraordinary franchises or exclusive privileges) should be construed fairly and not strictly; as Chief Justice Bigelow of Massachusetts said in *Brown v. Winnisimmet Co.*:¹ "We know of no rule or principle by which an act creating a corporation for certain specific objects, or to carry on a trade or business, is to be strictly construed as prohibitory of all other dealings or transactions not coming within the exact scope of those designated. Undoubtedly the main business of a corporation is to be confined to that class of operations which properly appertain to the general purposes for which its charter was granted. But it may also enter into contracts and engage in transactions which are incidental or auxiliary to its main business, or which may become necessary, expedient, or profitable in the care and management of the property which it is authorized to hold under the act by which it was created."²

Corporate powers to be construed reasonably.

powers, and a contract manifestly beyond those powers will not sustain an action against the corporation. But whatever under the charter and general laws, reasonably construed, may fairly be regarded as incidental to the objects for which the corporation is created, is not to be taken as prohibited." Justice Gray giving the opinion of the United States Supreme Court in *Green Bay and Minn. R. Co. v. Union Steam Boat Co.*, 107 U. S. 98. See also *People v. Utica Ins. Co.*, 15 Johns. 358; *New York Firemen Ins. Co. v. Sturgess*, 2 Cow. 164; *Same v. Ely*, 2 Cow. 678; *Commonwealth v. Erie and North East R. R. Co.*, 27 Pa. St. 339; *Diligent Fire Co. v. Commonwealth*, 75 Pa. St., 291.

A railroad company may contract with a city regarding a permission to use the latter's streets. *Indianola v. Gulf, W. T., and P. R'y.*, 56 Tex.

594. A corporation may have a trademark and may sue for its infringement. *Insurance Oil Tank Co. v. Scott*, 33 La. Ann. 946. When a bank takes property for a debt, it can make the expenditure necessary to put it into a productive condition. *Reynolds v. Simpson*, 74 Ga. 454.

But a power expressly excepted from a grant cannot be claimed as incidental to a power expressly granted. *Plummer v. Penobscot Lumbering Ass'n*, 67 Me. 363. And general words in a charter are not to be construed to authorize a corporation to do what is indictable. *State v. Krebs*, 64 N. C. 604.

¹ 11 Allen, 326, 336.

² See also *Toledo, Wabash and W. R. R. Co. v. Rodrigues*, 46 Ill. 188; *Railway Co. v. McCarthy*, 96 U. S. 258; *Clark v. Farrington*, 11 Wis. 306, 324. It is held in Michigan that a bank chartered with power to locate

§ 122. On the other hand, courts have decided, as exceptions, it may be said, to the general rule that corporate constitutions are to be fairly or liberally construed, that all exclusive privileges,¹ and all powers granted in derogation of public rights² or of the rights and franchises of other corporations,³ and all provisions whereby the state restricts its own action,⁴ are to be construed strictly against the corporation; nothing passing by implication.

§ 123. More definite statements may now be made respecting the particular powers of corporations. And first of all as to their implied power to raise money. Unquestionably, in the absence of express restrictions a corporation has impliedly the power to raise money⁵ in order to carry on its business, *i. e.*, effect the purposes of its incorporation.⁶ But by what means may it raise money? Certainly not by any means that an individual might employ, as, for instance, by speculating in cotton or in stocks.⁷ Rather, the constitution

its business in one county has no power to establish a branch agency in another. This is an act fatal in *quo warranto*. *People v. Oakland County Bank*, Dougl. (Mich.) 282. See *Detroit Fire, etc. Ins. Co. v. Judge of Saginaw Circuit*, 23 Mich. 492. In *Chapman v. Colby*, 47 Mich. 46, 50, Campbell, J., says, giving opinion of the Court, "It has uniformly been held in this state that corporations cannot remove from place to place, or establish branches for the transaction of their regular corporate business, unless authorized by law."

¹ See *Richmond, etc. R. R. Co. v. Louisa R. R. Co.*, 13 How. 71; *Perrine v. Chesapeake and Delaware Canal Co.*, 9 How. 172. Exclusive privileges and monopolies are not to be presumed. *Charles River Bridge Co. v. Warren Bridge Co.*, 11 Pet. 420; *DeLancey v. Insurance Co.*, 52 N. H. 581; *Gaines v. Coats*, 51 Miss. 335.

² See *Fertilizing Co. v. Hyde Park*,

97 U. S. 659; *Turnpike Co. v. Illinois*, 96 U. S. 63.

³ *Pennsylvania R. R. Co.'s Appeal*, 93 Pa. St. 150; *Packer v. Sunbury and Erie R. R. Co.*, 19 Pa. St. 211.

⁴ See § 489.

⁵ *E. g.*, in order to raise money, a railroad company may assign its claim for unpaid subscriptions to its stock. *Morris v. Cheney*, 51 Ill. 451.

⁶ But only for purposes properly within the scope of the corporate objects. See *In re Durham County Building Society*, Davis's and Wilson's Cases, L. R. 12 Eq. 516; *In re National Permanent Benefit Building Society, ex parte Williamson*, L. R. 5 Ch. 309.

⁷ See *Curtis v. Leavitt*, 15 N. Y. 9, 268.

But it has been held that a corporation is not restricted to means "usual and necessary" in carrying on its business; but may choose among the means convenient and adapted to the end con-

of a corporation being in its general nature enabling rather than restrictive, the correct rule would seem to be that a corporation may raise money only by the means expressly or impliedly authorized by its constitution.

§ 124. It goes without saying that in order to raise money a corporation may issue its own stock to the amount allowed by its charter or articles of association; and, ^{By issue of stock.} if authorized to do so, it can issue preferred stock.¹

But it cannot validly issue its stock below par as full paid stock.² A corporation may also sell its property in order to raise money.³

§ 125. A corporation is impliedly authorized to borrow money,⁴ and has the incidental power to give security for its re-payment.⁵ As such security a corporation may give its note;⁶ ^{By borrowing. Corporations may mort-} may mortgage its

templated by its charter. *Madison, etc. Plank Road Co. v. Watertown, etc. Plank Road Co.*, 5 Wis. 173; see *Clark v. Farrington*, 11 Wis. 306, 324.

¹ See §§ 571, 572.

² *Oliphant v. Woodburn, Coal & M'g Co.*, 63 Iowa, 332. See §§ 545, 701, 702.

³ See § 130.

⁴ *Curtis v. Leavitt*, 15 N. Y. 9; *Clark v. Titcomb*, 42 Barb. 122; *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159; *Oxford Iron Co. v. Spradley*, 46 Ala. 98; *Burr v. McDonald*, 3 Gratt. (Va.) 215; *Union Bank v. Jacobs*, 6 Humph. (Tenn.) 515; *Booth v. Robinson*, 55 Md. 419; *Thompson v. Lambert*, 44 Iowa, 239; *Savannah and Memphis R. R. Co. v. Lancaster*, 62 Ala. 555; *Ward v. Johnson*, 95 Ill. 215; *Bradley v. Ballard*, 55 Ill. 413; *Commissioners of Craven v. Atlantic and N. C. R. R. Co.*, 77 N. C. 289; *Lucas v. Pitney*, 27 N. J. L. 221; *Phila. and Reading R. R. Co. v. Stichter* (Sup. Ct. of Penn.), 21 Am. Law Reg. N. S. 713; *Bank of Australasia*

v. Breillat, 6 Moo. P. C. 152, 193, etc.; *In re International Life Assurance Soc.*, L. R. 10 Eq. 312; *Australian, etc. Co. v. Mounsey*, 4 K. & J. 733. See also authorities in succeeding notes.

⁵ *Fifth Ward Savings Bank v. First Nat. Bank*, 48 N. J. L. 513. As incidental to its implied power to borrow money, an insurance company has power to transfer its assets in trust for the security of lenders. *Nelson v. Eaton*, 26 N. Y. 410; see *Hope Mut. Life Ins. Co. v. Perkins*, 38 N. Y. 404. And a mutual insurance company may transfer its premium notes as collateral security for its debts. *Brookman v. Metcalf*, 32 N. Y. 591. Authority given by the charter of a corporation to its board of directors to execute a mortgage or deed of trust of its property and franchises, in order to secure its bonds, does not negative other methods. *Uncas Nat. Bk. v. Rith*, 23 Wis. 339.

⁶ A business corporation has implied power to make negotiable notes, and to indorse accommodation notes loaned

gage their
property.
Excep-
tions.

property;¹ and may issue coupon bonds payable to bearer secured by a mortgage of its property.² But a corporation that receives from the state special or extraordinary franchises in order that it may the better serve the public in some employment in which the public has a pronounced interest, cannot without express authority mortgage its franchises.³ As Justice Gray said in *Richardson v. Sibley*,⁴

to it. *Auerbach v. La Seur Mill Co.*, 28 Minn. 291; *Rockwell v. Elkhorn B'k*, 13 Wis. 653; *Lucas v. Pitney*, 27 N. J. L. 221; *Hamilton v. New Castle, etc. R. R. Co.*, 9 Ind. 359; *Hardy v. Merriweather*, 14 Ind. 203; *Frye v. Tucker*, 24 Ill. 181. But see *James v. Rogers*, 23 Ind. 451; *Bacon v. Miss. Ins. Co.*, 31 Miss. 116. The note of a corporation signed by its treasurer may be negotiable although the corporate seal is attached. *Bank v. Railroad Co.*, 5 S. C. 156.

¹ *Savannah and Memphis R. R. Co. v. Lancaster*, 62 Ala. 555; *Kelly v. Alabama and Cincinnati R. R. Co.*, 58 Ala. 489; *Thompson v. Lambert*, 44 Iowa, 239; *Susquehanna Bridge Co. v. General Ins. Co.*, 3 Md. 305; *Lehigh Valley Coal Co. v. Agricultural Works*, 63 Wis. 45.

The power to mortgage, when not expressly given or denied, may be regarded as incidental to the power to take and hold real estate, and make contracts. *Aurora Agricultural Soc. v. Paddock*, 80 Ill. 263; *West v. Madison County Agricultural Board*, 82 Ill. 205; *Taylor v. Agricultural, etc. Asso.*, 68 Ala. 229; *Jackson v. Brown*, 5 Wend. 590; *Central Gold Mining Co. v. Platt*, 3 Daly, 263; *Watts's Appeal*, 78 Pa. St. 370, 391. Authority in the charter of a railroad company "to acquire, alien, transfer, and dispose of property of every kind," in-

cludes the power to mortgage. *McAllister v. Plant*, 54 Miss. 106.

A corporation having authority to mortgage its property for the purpose of carrying on its business, may execute a mortgage to secure the payment of future advances. *Jones v. Guaranty and Indemnity Co.*, 101 U. S. 622. But a corporation formed under the New York Manufacturing Companies Act of 1848 has authority to mortgage its property only to secure the payment of a debt; not to raise money. *Carpenter v. Black Hawk Gold Mg. Co.*, 65 N. Y. 43; see *Davidson v. West Chester Gaslight Co.*, 99 N. Y. 559. The scope of *Carpenter v. Black Hawk Gold Mg. Co.* is narrowed down to very little by *Lord v. Yorker Fuel Gas Co.*, 99 N. Y. 547.

² See *Commissioners of Craven v. Atlantic and N. C. R. R. Co.*, 77 N. C. 289.

³ *Coe v. Columbus, etc. R. R. Co.*, 10 Ohio St. 372; *Atkinson v. Marietta, etc. R. R. Co.*, 15 Ohio St. 21; *State v. Morgan*, 28 La. Ann. 482; *Pullan v. Cincinnati, etc. R. R. Co.*, 4 Biss. 35; *Daniels v. Hart*, 118 Mass. 543; *Palmer v. Forbes*, 23 Ill. 301. See *Carpenter v. Black Hawk Gold Mg. Co.*, 65 N. Y. 43, 50. But see *Kennebec, etc. R. R. Co. v. Portland, etc. R. R. Co.*, 59 Me. 9, 23; *Shepley v. Atlantic, etc. R. R. Co.*, 55 Me. 395, 407.

⁴ 11 Allen, 65, 67.

a case which held that a horse-railroad could not mortgage its road and franchises: "A corporation created for the very purpose of constructing, owning, and managing a railroad, for the accommodation and benefit of the public, cannot, without distinct legislative authority, make any alienation, absolute or conditional, either of the general franchise to be a corporation, or of the subordinate franchise to manage and carry on its corporate business, without which its franchise to be a corporation can have little more than a nominal existence."¹ When, however, authority to pledge the franchises of a corporation exists, there is implied, as incidental thereto, the power to pledge everything necessary to their enjoyment, including property not yet acquired by the corporation.²

§ 126. Sometimes a corporation, as for instance a railroad company, issues securities of a peculiar nature, like "deferred income bonds;" which may be irredeemable, and entitled to interest only after a certain percentage of dividends has been paid on the stock. In a recent Pennsylvania case, a railroad corporation was held to have the implied power to issue such securities.³

"Deferred income bonds."

§ 127. Finally, in order to raise money, a corporation is not restricted to borrowing on its own securities; for it has been held that a railroad corporation, having power to raise money on its own bonds, may guaranty the bonds of cities and counties which have been lawfully issued to aid the company to build its road;⁴ and also that a railroad cor-

Power to guaranty.

¹ See *Commonwealth v. Smith*, 10 Allen, 448. Power to sell its property conferred on a corporation in strong and general terms, includes the power to mortgage, *Willamette Mg. Co. v. Bank of British Columbia*, 119 U. S. 191. Compare *East Boston R. R. Co. v. Eastern R. R. Co.*, 13 Allen, 422, where it was said that the right to mortgage might be inferred from the terms of a statute not expressly authorizing it. See §§ 304, 305.

² *Phillips v. Winslow*, 18 B. Mon. (Ky.) 431; see §§ 676, 817.

³ *Phila. and Reading R. R. Co. v.*

Stichter, 21 Am. Law Reg. N. S. 713. But in *Taylor v. Phila. and Reading R. R. Co.*, 7 Fed. Rep. 386 (U. S. Cir. Ct.), it was decided to be beyond the power of the same corporation to issue these very bonds; the court taking the view that the transaction was not a loan, properly speaking, there being no promise to return the principal. See *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 177.

⁴ *Railroad Co. v. Howard*, 7 Wall. 392; see *Bonner v. City of New Orleans*, 2 Woods, 135.

poration may guaranty the bonds of another railroad company whose road it competently leases.¹

With respect to the amount of money that a corporation may borrow, no more definite rule can be laid down than this general proposition: in the absence of express restriction,² it is legally competent for a corporation to borrow whatever moneys may be required for its business.³

§ 128. At common law every corporation aggregate had incidentally the power to purchase, hold, and alienate such real estate as the purposes of its incorporation required.⁴ But this common law capacity was annulled as far back as the time of Henry III., by the beginning of the series of statutes of mortmain, of which the latest was passed in the ninth year of George II. These statutes were at first intended merely to prevent the accumulation of real estate in the hands of the Church; but by later enactments,⁵ civil or lay corporations as well as ecclesiastical were forbidden to purchase lands.⁶ In this country the statutes of mortmain have not been re-enacted nor generally assumed to be in force.⁷ Accordingly, the law would seem to be that a stock corporation may purchase such real estate as is essential or reasonably necessary in its business for carrying out the purposes of its incorporation; and this proposition applies especially to corporations formed under general enabling statutes.⁸ Further, a

¹ *Low v. California Pacific R. R. Co.*, 52 Cal. 53. Compare *Bank v. Flour Co.*, 41 O. St. 552.

² See *Ossipee H. and W. Co. v. Canney*, 54 N. H. 295; *Auerbach v. Le Seur Mill Co.*, 28 Minn. 291; also § 286.

³ *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. 280, 308.

⁴ See Chap. II.; *Angell and Ames on Corp.*, § 145; 1 *Kyd on Corp.*, 69; 2 *Kent's Com.*, 277; *McCartee v. Orphan Asylum*, 9 Cow. 437, 462; *People v. La Rue*, 67 Cal. 526.

⁵ 15 R. II., c. 5.

⁶ For a history and discussion of the

statutes of mortmain, see 1 *Kyd*, 78-104.

⁷ 2 *Kent's Com.*, 282; see also *Page v. Heineberg*, 40 Vt. 81; *Odell v. Odell*, 10 Allen, 1, 6; *Perin v. Carey*, 24 How. 465, 507; *Potter v. Thornton*, 7 R. I. 252. These statutes are in force in Pennsylvania, 3 *Binney*, 626. But how far they would be applied to business or stock corporations is questionable; see *Miller v. Porter*, 53 Pa. St 292.

⁸ *State v. Mansfield*, 23 N. J. L. 510; *State v. Newark*, 1 Dutch. 315; 2 *Kent's Com.*, 282; see *Riley v. Rochester*, 9 N. Y. 64, *Bostock v.*

corporation authorized to hold land, may take a fee, although its own term of existence is limited to a period of years: *i. e.*, for purposes of alienation it takes the fee, while for the purposes of enjoyment of the land, in the nature of things its estate must be limited in time to the term of its own existence.¹

§ 129. The power of a corporation to acquire personal property is unlimited, unless there are special restrictions in its constitution.²

Power to acquire personal property.

§ 130. In the course of its business, and for the furtherance of the ends of its incorporation, a corporation may alienate,³ or lease,⁴ a portion or even

Power to alienate.

North Staffordshire R'y, 4 El. & Bl. 798; compare *Page v. Heineberg*, 40 Vt. 81; *Coleman v. San Rafael Turnpike Co.*, 49 Cal. 517.

A turnpike company may hold under lease premises necessary for storing implements used in road repairs, and sheltering its servants. *Crawford v. Longstreet*, 43 N. J. L. 325.

When a corporation is authorized to hold land for some specified purpose, the presumption is that land acquired by it was acquired for that purpose. *Mallet v. Simpson*, 94 N. C. 37.

"Corporations when considered with reference to their powers to take and hold real estate may be classified as follows:—

"First, those whose charter or law of creation forbids that they should acquire or hold real estate. In which case a corporation cannot take or hold real estate; and a deed or devise to it passes no title.

"Secondly, those whose charter or law of creation is silent on the subject. In such case, as a general rule, there is no power to acquire and hold such property. But if the objects for which the corporation was formed cannot be accomplished without acquiring and

holding the title to real estate, the power to do so is implied.

"Thirdly, those corporations whose charter, etc. authorizes them in some cases, or for some purposes, to take and hold the title to real estate. In these cases, as the corporation may for some purposes acquire and hold title, it cannot be questioned by any party, except the state, whether the real estate has been acquired for the authorized purposes or not.

"Fourthly, those whose charter, etc. confer a general power to acquire and hold real estate. Such corporations may take and hold real estate as freely and as fully as natural persons." *Hayward v. Davidson*, 41 Ind. 212.

For the effect of a conveyance to a corporation of property which it is unauthorized to take, see § 303.

¹ *Nicoll v. New York and Erie R. R.*, 12 N. Y. 121; *Rives v. Dudley*, 3 Jones Eq. (N. C.) 126.

² 1 Kyd, 104; *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. 280. Statutes of mortmain do not apply to personal property. 1 Kyd, 104.

³ *Wilson v. Miers*, 10 C. B. N. S. 348; *Hancock v. Holbrook*, 9 Fed. Rep. 353.

⁴ See *Featherstonhaugh v. Lee Moor Porcelain Clay Co.*, L. R. 1 Eq. 318.

the whole of its property; and may assign its property in trust for the benefit of its creditors.¹ But the proposition, that to accomplish the ends of its incorporation, a corporation may deal with its property just as an individual, is too broad.² And the preceding statements regarding the power of a corporation to alienate its property are subject to the following qualifications: a corporation cannot alienate or assign its property regardless of the rights of its creditors, or of a dissenting minority of shareholders;³ and a corporation owing duties to the public cannot, without special authority, alienate, lease, or mortgage its franchises, or do any act that may disable it from performing its public duties in the manner indicated by its constitution.⁴

§ 131. The general statement is often made, that a corporation cannot transfer its franchises to another corporation, or to an individual.⁵ Especially, it is said, a corporation cannot transfer its franchise to be a cor-

Power to
transfer
franchises.

¹ *State v. Bank of Maryland*, 6 Gill & J. (Md.) 205; *Union Bank v. Elliott*, ib. 363; *Ardesco Oil Co. v. North Am. Oil Co.*, 66 Pa. St. 375; *Fouche v. Brower*, 74 Ga. 251.

² For instance, it is held that a corporation cannot form a partnership with another corporation or with an individual. *Marine Bank v. Ogden*, 29 Ill. 248; *Whittenton Mills v. Upton*, 10 Gray, 582; compare *Allen v. Woonsocket Co.*, 11 R. I. 288; *French v. Donohue*, 29 Minn. 111. This proposition certainly holds true when the business for which the partnership is formed is *ultra vires* the corporation; thus a railroad corporation has no power to form a partnership with an individual to run a line of boats. *Gunn v. Central Railroad*, 74 Ga. 509. But one manufacturing company can take shares in another in payment of a debt. *Howe v. Boston Carpet Co.*, 16 Gray, 493. Whether the purchase

of shares in another corporation is *ultra vires* or not depends on the purpose for which it was made, and whether, under the circumstances, it was a reasonable or necessary means of carrying out corporate objects. *Hill v. Nisbet*, 100 Ind. 341. In *Nassau Bank v. Jones*, 95 N. Y. 115, it was held to be beyond the powers of a state bank to purchase stock in a railroad corporation. See also § 309.

³ See §§ 608, 609 for a discussion of the right of a majority to dispose of the corporate assets, and close the business of the corporation. And, for a discussion of assignments by corporations for the benefit of its creditors, with or without preferences, see § 668.

⁴ See §§ 304, 305, 125.

⁵ See *Carpenter v. Black Hawk Gold Mfg. Co.*, 65 N. Y. 43, 50; *Branch v. Jessup*, 106 U. S. 468, 484.

poration.¹ And this on the ground that a grant of franchises or privileges from the legislature to a body of men gives to that body no authority to transfer these franchises and privileges to others. In effect, such a transfer would be a conferring of the power to act as a corporation;² a power which, it is needless to say, only the legislature can confer. If a corporation is expressly authorized to transfer its franchises, then its grantee receives them indirectly from the legislature by virtue of express power conferred on the corporation to authorize another body of men to exercise its franchises or similar ones.³

§ 132. These statements are all correct enough. The trouble with them is, that, except in regard to a single class of corporations, they have little practical import. The class of corporations referred to are railroad and other corporations charged with the performance of public duties, who receive special franchises the better to enable them to fulfill these duties. And in regard to such corporations there is a further reason why it is incompetent for them to transfer their franchises, *i. e.*, the general rule forbidding them to do any act that may put it out of their power to serve the public as they were intended to serve it.⁴ But what do the franchises of an ordinary business or manufacturing corporation amount to? To nothing but a legal competency to act in a certain manner, which they have acquired by complying with certain formalities. There is nothing special or extraordinary about their franchises. In

¹ *Meyer v. Johnston*, 53 Ala. 237, 325; *Coe v. Columbus, etc. R. R. Co.*, 10 Ohio St. 372; *Eldridge v. Smith*, 34 Vt. 484; *Willamette M'fg Co. v. Bank of British Columbia*, 119 U. S. 191. Franchises to build, own, and manage a railroad are not necessary corporate rights, but are capable of being enjoyed by natural persons; and may be assigned by the corporation possessing them. Not so as to the franchise to be a corporation. *Ragan v. Aiken*. 9 Lea (Tenn.), 609.

² *State of Ohio v. Sherman*, 22 Ohio St. 411, 428; *Memphis & L. R.*

R. R. Co. v. Railroad Commissioners, 112 U. S. 609, 622.

³ How far the first corporation could exercise its franchises after a transfer of them would depend on the construction of its constitution, and especially on the construction of the power therein contained to transfer the corporate franchises.

⁴ See §§ 304, 305, 125, and §§ 490, 491, as to transferring special immunities. As a matter of fact, questions regarding the validity of a transfer or mortgage of franchises almost always arise in relation to corporations of this class.

truth, their franchises are hardly worth transferring. Persons acquiring their property by purchase or under foreclosure may readily form themselves also into a corporation, if corporate organization is desired. Unquestionably the particular competency which a body of men by complying with certain statutory provisions have acquired is not transferable to another body who have not complied with those provisions; any more than may be transferred the competency to act as a limited partnership, which persons may have acquired through compliance with the statute authorizing limited partnerships. Just as in regard to limited partnerships, so in regard to corporations, the general intention of enabling statutes is that persons who have complied with certain formalities may act as a corporation; that others may not.¹ It will simplify matters here as elsewhere, to view them as they practically are; and not to talk vaguely about the incompetency of corporations to transfer their franchises.²

§ 133. When the capital stock is fixed in amount by the constitution of the corporation, as is ordinarily the case, the corporation has no power to increase or diminish its stock, unless expressly authorized so to do;³ nor has it the power to increase or decrease the number

Power to
increase or
decrease
the capital
stock.

¹ "The franchise of becoming and being a corporation, in its nature, is incommunicable by the act of the parties and incapable of passing by assignment." *Memphis & L. R. R. Co. v. Railroad Commissioners*, 112 U. S. 609, 619, Opin. of Court per Matthews, J. See § 131. Validly mortgaging the charter, property, and franchises of a railroad corporation, does not transfer the right or capacity to be that identical corporation; though it would transfer such franchises as are more appropriate to the construction, maintenance, and operation of the railroad as a public highway and the right to make profit therefrom. The only right of corporate existence that could pass would be the right to organize under the then laws of the state. "The

franchise to be a corporation remained in and was exercised by the old corporation, notwithstanding the mortgage of its charter, until the new corporation was formed and organized; it was then surrendered to the state, and by a new grant then made, passed to the incorporators of the new corporation, it was held and exercised by them under the constitutional restrictions then in being." *Ib.* p. 623. See with above, *Eldridge v. Smith*, 34 Vt. 484.

² Indirectly a transfer of the franchises of a corporation can be accomplished by a purchase of all the stock by the would-be transferees.

³ In *New York and N. H. R. R. Co. v. Schuyler*, 34 N. Y. 30; *Sutherland v. Olcott*, 95 N. Y. 93; *Grangers' Life, etc. Ins. Co. v. Kamper*,

of shares into which the capital stock is divided.¹ And when power is given to increase or decrease the capital stock or the number of shares into which it is divided, the mode of proceeding indicated by the statute or articles of association must be substantially adhered to.²

§ 134. In regard to the power of a corporation to purchase shares of its own stock, there is a difference of opinion. The English decisions seem unanimously to negative the possession of this power by corporations; and Mr. Brice's proposition—"Corporations cannot, whatever the nature of their business, without an express and very clear power in that behalf, deal in their own shares"—may be regarded as expressing, though somewhat vaguely, from his use of the word "deal," the English law on this subject.³

Power of a corporation to purchase shares of its own stock.

73 Ala. 325; *Smith v. Goldsworthy*, 4 Q. B. 430; see *Railway Co. v. Allerton*, 18 Wall. 233, 235; *Droitwich Patent Salt Co. v. Curson*, L. R. 3 Ex. 35; and compare *In re Financial Corporation*, *Holmes's Case*, L. R. 2 Ch. 714.

¹ *Oldtown R. R. Co. v. Veazie*, 39 Me. 571; *Salem Mill Dam Co. v. Ropes*, 6 Pick. 23, 32.

² *Spring Co. v. Knowlton*, 103 U. S. 49; *Knowlton v. Congress Spring Co.*, 57 N. Y. 518. See *State v. McGrath*, 86 Mo. 239, and compare *Columbia National Bank's Appeal*, 16 Weekly Notes of Cases (Pa.) 357. See, also, cases cited in the two preceding notes.

However, a corporation having earned a dividend, and possessing the power to increase its capital stock, may declare a stock dividend. *Howell v. Chicago and N. W. R'y Co.*, 51 Barb. 378. When an increase of stock is contemplated by the articles of association, and made in the exercise of a power given by statute, and in the

manner prescribed by statute, if the new stock is properly disposed of, so that in the disposition plaintiff's rights are observed, the motives leading the majority of shareholders (and directors) to vote for it are immaterial. *Jones v. Morrison*, 31 Minn. 140. See, also, § 568.

³ "Ultra Vires," 2d Am. ed., 94. *Zulueta's Claim*, L. R. 5 Ch. 444; *In re Marseilles Extension R'y Co.*, *ex parte Credit Foncier of England*, L. R. 7 Ch. 161; see *Evans v. Coventry*, 25 L. J. Ch. 489; *Hall's Case*, L. R. 5 Ch. 707. Compare *Hope v. International Financial Soc'y*, L. R. 4 Ch. D. 327; *Teasdale's Case*, L. R. 9 Ch. 54. Even though the corporation has power to purchase shares in other corporations. Same cases. *Copin v. Greenless & Co.*, 38 Ohio St. 275, follows the English rule, and holds that an executory contract between a corporation and a shareholder for the purchase of its own stock by the former cannot be enforced, and will not sustain an action for damages against the

§ 135. In America, on the other hand, the weight of authority clearly indicates that there is nothing in itself illegal or *ultra vires* in the purchase of its own shares by a corporation; and that whether the purchase is valid depends on the condition of the corporate affairs, the purpose for which the purchase was made (or the shares received by the corporation), and on the relation to the corporation of the persons questioning the validity of the transaction.¹ Thus a solvent corporation may receive fully paid-up shares of its own stock in payment of or as security for a debt owing the corporation.² But an insolvent corporation can neither purchase, nor receive in payment of debts owing it, shares of its own stock; especially when the shares are not fully paid up or when individual liability exists respecting them; for, under such circumstances, the effect would be to impair the corporate assets to the detriment of creditors and holders of other shares.³ In general, no purchase by a corporation of its stock can relieve the prior holder from his statutory individual liability to creditors.⁴

corporation. For the power of a corporation to purchase shares in the stock of another corporation see § 130, note.

¹ *Vail v. Hamilton*, 85 N. Y. 453, 457; *Dupee v. Boston Water-power Co.*, 114 Mass. 37, 43; *Clapp v. Peterson*, 104 Ill. 26; *Chicago, Pekin, etc. R. R. Co. v. Marseilles*, 84 Ill. 145; *S. C.*, 84 Ill. 643; *Fraser v. Ritchie*, 8 Ill. App. 554; *Hartridge v. Rockwell, R. M. Charton (Ga.)*, 260; *Iowa Lumber Co. v. Foster*, 49 Iowa, 25; *Verplanck v. Mercantile Ins. Co.*, 1 Edw. Ch. (N. Y.) 84, 94; *City Bank v. Bruce*, 17 N. Y. 507; *Coleman v. Columbia Oil Co.*, 51 Pa. St. 74. Unissued stock of a corporation was by an agreement of all the shareholders (who were also directors), there being no creditors, paid for with the funds of the corporation and issued to one of their number in trust for them all. *Held*, the issue was valid, or at least could be impeached by no person.

Jones v. Morrison, 31 Minn. 140. The statutory provisions of the different states regarding the purchase by a corporation of its stock are collected, with many authorities on the subject, in an article by Mr. E. C. Moore, Jr., 8 Southern Law Rev. N. S. 369.

² *Taylor v. Miami Exporting Co.*, 6 Ohio, 177; *State Bank v. Fox*, 3 Blatchf. 431; *City Bank v. Bruce*, 17 N. Y. 507; *Ex parte Holmes*, 5 Cow. 426. See *Cooper v. Frederick*, 9 Ala. 738; *Barton v. Port Jackson, etc. Plank Road Co.*, 17 Barb. 397. Compare *First Nat. Bk. v. Nat. Exchange Bk.*, 92 U. S. 122. So it is said a corporation may receive its shares in exchange for property owned by it. *Clapp v. Peterson*, 104 Ill. 26.

³ *Currier v. Lebanon Slate Co.*, 56 N. H. 262; *Savings Bank v. Wulfe-kuhler*, 19 Kans. 60; *Crandall v. Lincoln*, 52 Conn. 73. See §§ 552, 747.

⁴ See § 747.

§ 136. When a corporation has competently purchased shares of its own stock, it may hold them unextinguished and reissue them;¹ but while the corporation holds the shares, it cannot exercise in regard to them privileges which pertain to an ordinary shareholder. Especially it cannot vote on them; and this last proposition is not affected by the fact that the shares stand in the name of some trustee for the corporation, or in the names of the directors.²

A corporation may reissue shares purchased by it; but cannot vote on them.

§ 137. In the enforcement of its rights, a corporation has equal capacity with an individual to bring actions,³ compromise them,⁴ and refer matters to arbitration.⁵ A corporation may sue to recover damages for a libel against it in its business;⁶ to restrain a nuisance on its property;⁷ to enjoin others from using its corporate name to the injury of its trade;⁸ or, in admiralty, to recover for services

Capacity of a corporation to sue.

¹ *State v. Smith*, 48 Vt. 266; *City Bank v. Bruce*, 17 N. Y. 507; *Williams v. Savage M'fg Co.*, 3 Md. Ch. 418; *Rivanna Navigation Co. v. Dawson*, 3 Gratt. (Va.) 19, 25; *Clapp v. Peterson*, 104 Ill. 26; *Commonwealth v. Boston and A. R. R. Co.*, 142 Mass. 146.

² *Vail v. Hamilton*, 85 N. Y. 453; *Ex parte Holmes*, 5 Cow. 426; *Brewster v. Hartley*, 37 Cal. 15; *Monseaux v. Urquhart*, 19 La. Ann. 482; *American Railway Frog Co. v. Haven*, 101 Mass. 398.

The corporation cannot as representing shares held by it give its assent to a mortgage of corporate property, in order to make up the assent of two-thirds of the shareholders as required by statute. *Vail v. Hamilton, supra*. See § 185.

³ A corporation has the right to sue at common law, see §§ 12, 14; and has power to execute a bond in a judicial proceeding. *Collins v. Hammock*, 59 Ala. 448.

⁴ See *First Nat. Bk. v. Nat. Exchange Bk.*, 92 U. S. 122; *Stewart v. Hoyt*, 111 U. S. 373.

⁵ *Alexandria Canal Co. v. Swann*, 5 How. 83; see *Day v. Essex County Bank*, 13 Vt. 97; *Boston & L. R. R. Co. v. Nashua, etc. R. R. Co.*, 139 Mass. 463; compare *Sawyer v. Winnegance Mill Co.*, 26 Me. 122.

⁶ *Trenton Mut. Life Ins. Co. v. Perrine*, 23 N. J. L. (3 Zab.) 402; *Hahne-mannian Life Ins. Co. v. Beebe*, 48 Ill. 87; *Shoe and Leather Bk. v. Thompson*, 23 How. Pr. (N. Y.) 253; *Knickerbocker Life Ins. Co. v. Ecclesine*, 42 How. Pr. (N. Y.) 201; *Same v. Same*, 2 J. & S. (N. Y. Super. Ct.) 76; *Metropolitan Omnibus Co. v. Hawkins*, 4 H. & N. 87.

⁷ *Central Bridge Co. v. Lowell*, 4 Gray, 474.

⁸ *Newby v. Oregon Cent. R. Co. v. Deady*, 609; *Holmes v. Holmes, M'fg Co.*, 37 Conn. 278.

rendered as a salvor.¹ Pleading the general issue admits the capacity of a corporation plaintiff to sue, and relieves it from proving its corporate existence;² and going to trial on the merits has a similar effect.³ In some states it is not necessary for a corporation plaintiff to allege its incorporation.⁴

§ 138. When in order to enforce corporate rights or avert wrongs threatening the corporate interests it is necessary to sue, the rule is that the suit must be brought by the corporate management in the name of the corporation. This rule applies to suits both at law and in equity.⁵ Individual shareholders are not the proper parties to sue or defend on behalf of corporate interests.⁶ If,

Suits must
in general
be brought
in the name
of the cor-
poration.

¹ *The Camanche*, 8 Wall. 448; *The Blackwell*, 10 Wall. 1. A corporation may acquire a lien for materials furnished as an individual. *Fagan v. Boyle Ice Machine Co.*, 65 Tex. 324.

² *Morse Arms M'fg Co. v. United States*, 16 Ct. of Claims, 296; *McIntire v. Preston*, 10 Ill. 48; *Phoenix Bank v. Curtis*, 14 Conn. 437; *Prince v. Commercial Bank*, 1 Ala. 241; *Mississippi, etc. R. R. Co. v. Cross*, 20 Ark. 448; *Rockland, etc. Steamboat Co. v. Sewall*, 78 Me. 167. But this was not the English rule, nor has it been so held in all the States. See *Williams v. Bank of Michigan*, 7 Wend. 540, and, generally, *Angell and Ames on Corp.*, §§ 632 *et seq.*

³ *United States v. Insurance Cos.*, 22 Wall. 99; *Conard v. Atlantic Ins. Co.*, 1 Pet. 386, 450; *Lehigh Bridge Co. v. Lehigh Coal Co.*, 4 Rawle, 9; *First Parish v. Cole*, 3 Pick. 232, 245.

⁴ *German Reformed Church v. Von Puechelstein*, 27 N. J. Eq. 30; *Phoenix Bank v. Donnell*, 40 N. Y. 410; compare *Baltimore & O. R. R. Co. v. Sherman*, 30 Grat. (Va.) 602. But see §§ 1775-6 of the New York Code of Civil Procedure, and *Concordia Savings Ass'n v. Reed*, 93 N. Y.

474. Where the name used by the plaintiff in pleading "argues a corporation," corporate organization need not be averred. *Sayers v. First Nat. B'k.*, 89 Ind. 230.

⁵ *Bradley v. Richardson*, 2 Blatchf. 343; *Mauney v. High Shoals M'fg Co.*, 4 Ired. Eq. (N. C.) 195; see *Insane Hospital v. Higgins*, 15 Ill. 185; *Campbell v. Brunk*, 25 Ill. 225.

⁶ *Silk M'fg Co. v. Campbell*, 27 N. J. L. 539; *Blackman v. Central R. R. Co.*, 58 Ga. 189; *Henry v. Elder*, 63 Ga. 347; see *Bronson v. La Crosse, etc. R. R. Co.*, 2 Wall. 283; *Park v. Petroleum Co.*, 25 W. Va. 108. Shareholders who have been allowed to put in answers in the name of the corporation cannot be regarded as answering for the corporation itself. In a special case, where there is an allegation that the directors fraudulently refused to attend to the interests of the corporation, a court of equity will in its discretion allow a shareholder to become a party defendant in order to protect from unfounded claims against the corporation his own interests and those of such other shareholders as choose to join him in the defence. *Bronson v. La Crosse, etc. R. R. Co.*,

however, the corporate management refuses or fails to enforce corporate rights, and an irreparable injury to the corporate interests is threatened, a shareholder, in a case where the corporation itself would be entitled to an injunction, may bring suit on behalf of himself and others interested who may join, to enjoin the threatened injury.¹ In such case the shareholder should set forth in his complaint or bill the efforts that he has made to induce the corporation to act in the matter, should allege its refusal or failure to sue, and should make it a party defendant in the action.

§ 139. The first leading case on the right of a shareholder to sue under such circumstances is *Dodge v. Woolsey*,² where the Supreme Court of the United States held that a shareholder in a bank could maintain a bill to enjoin the collection of an unlawful state tax on the bank, the directors having declined to sue under circumstances that rendered their refusal a breach of trust.³ It is to be noted that this case was decided before the

When a shareholder may sue on behalf of the corporation.

2 Wall. 283. A shareholder cannot prosecute an appeal from a judgment against the corporation. *State of Florida v. Florida Central R. R. Co.*, 15 Fla. 690.

¹ A bill may be filed by shareholders to enjoin the setting up of a claim for purchase-money against the lands of a company, the ground of the bill being that the party setting up the claim induced the complainants to buy shares by fraudulently representing that the property sold to the company was unincumbered, and that he had no interest in it; the agents of the company joining in such misrepresentations. The company should be made a party defendant, although the relief prayed is really in its favor. *Jones v. Bolles*, 9 Wall. 364.

² 18 How. 331. The present discussion relates to actions by shareholders against outsiders; and has but incidental reference to the right of sharehold-

ers to sue the corporation and restrain it by legal process (for which see §§ 553-557); or to their right to sue the officers for a breach of duties owing primarily to the corporation (for which see §§ 683-691).

³ "The judgment of the court in *Dodge v. Woolsey* authorizes the stockholder of a company to institute a suit in equity in his own name against a wrong-doer, whose acts operate to the prejudice of the interests of stockholders, such as diminishing their dividends and lessening the value of their stock, in a case where application has first been made to the directors of the company to institute a suit in its own name, and they have refused. This refusal of the board of directors is essential in order to give to the stockholder any standing in court, as the charter confers upon the directors representing the body of shareholders the general management of the business of

act of congress of March 3d, 1875, which permits all suits arising under the constitution or laws of the United States to be brought originally in the Federal circuit courts, without regard to the citizenship of the parties. The bank had been incorporated by the state of which Dodge, the tax-collector, was a citizen. Consequently, as the law stood at the time, a writ of error to the state court from the Supreme Court of the United States, was the only means by which the bank could have carried into a Federal court the right it possessed under the United States constitution to be relieved from the tax in question, which impaired the obligation of a contract.¹

§ 140. Unless the facts stated in the complaint clearly show the corporation to be in no position to protect itself, so that any attempt of the shareholder to procure it to act for its own protection would be utterly useless,² the shareholder must allege a demand by him on the corporate management to bring suit;³ and should set forth in his complaint facts showing to the court that his endeavors have been real and earnest, and that he has left undone nothing which in reason he might have done to pre-

Shareholder must allege demand on the corporation to sue.

the company. There must be a clear default on their part, involving a breach of duty, within the rule established in equity, to authorize a stockholder to institute the suit in his own behalf, or for himself and other stockholders who may choose to join." Opinion of the court per Nelson, J., in *Memphis City v. Dean*, 8 Wall. 64, 73; see also *People v. State Treasurer*, 24 Mich. 468.

¹ See *Hawes v. Oakland*, 104 U. S. 450, 459.

² *Barr v. New York L. E. & W. R. R. Co.*, 96 N. Y. 444. Where the corporation is practically dissolved, and all its officers have absconded, a shareholder may sue a person to whom the officers have fraudulently and without consideration conveyed the cor-

porate property; and under such circumstances need not allege a previous application to the corporation. *Wilcox v. Bickel*, 11 Neb. 154. See also *People v. Hektograph Co.*, 10 Abb. N. C. (N. Y.) 358; *Davis v. Railroad Co.*, 1 Woods, 661; *Crumlish v. Railroad Co.*, 28 W. Va. 623.

³ *Detroit v. Dean*, 106 U. S. 537; *Hawes v. Oakland*, 104 U. S. 450; *Shawhan v. Zinn*, 79 Ky. 300; *Morgan v. Railroad Co.*, 1 Woods, 15; *Ware v. Bazemore*, 58 Ga. 316. Compare *Kennedy v. Gibson*, 8 Wall. 498. This proposition, it is said, does not apply to a bill filed by a creditor of the corporation against a wrong-doer. *Lothrop v. Stedman*, 42 Conn. 583 (U. S. Cir. Ct.).

vail on the corporate management to bring the action.¹ Moreover, it must be shown in the complaint that the refusal of the directors to sue is a breach of trust on their part, and not a mere error of judgment in a matter properly within their discretion.² Finally, it is always essential that the corporation itself should be made a party defendant.³

§ 141. In *Hawes v. Oakland*,⁴ where the rules under discussion received the most careful consideration, the following statement was made by Justice Miller, giving the opinion of the court:—

“We understand [the doctrine of the English and American cases, including *Dodge v. Woolsey*] to be that to enable a stockholder in a corporation to sustain in a court of equity in his own name a suit founded on a right of action existing in the corporation itself, and in which the corporation itself is the appropriate plaintiff, there must exist as the foundation of the suit—

“Some action or threatened action of the managing board of directors or trustees of the corporation which is beyond the au-

¹ *Hawes v. Oakland*, 104 U. S. 450, 461; *Dimpfell v. Ohio*, etc. R. Co., 110 U. S. 209; *Bacon v. Irvine*, 70 Cal. 221; *Dannmeyer v. Coleman*, 11 Fed. Rep. 97; *Pacific Railroad v. Missouri Pacific R. R. Co.*, 2 McCrary, 227. See also the cases in the preceding note. To give a small minority of shareholders a standing in equity to contest and set aside an *ultra vires* act of directors to which a large majority of shareholders make no objection, it must appear that complainants were shareholders at the time of the transactions complained of, or that the shares have devolved on them since by operation of law. *Dimpfell v. Ohio & Miss. R. Co.*, 110 U. S. 209.

² See the cases in last note but one; also *Memphis Gas Co. v. Williamson*, 9 Heisk. (Tenn.) 314, 337; *Dodge v. Woolsey*, *supra*; *Memphis City v. Dean*, *supra* (§ 139, note).

³ See cases in preceding notes. It has even been said that the failure to make the corporation a party is not a mere defect of parties to be taken advantage of by special demurrer, but leaves the shareholder without a cause of action; the party entitled to the relief, *i. e.*, the corporation, not being before the court. *Shawhan v. Zinn*, 79 Ky. 300.

⁴ 104 U. S. 450, 460. It will be borne in mind that the Federal courts, in thus strictly limiting the right of shareholders to sue for the corporation, have an eye to the protection of their own dockets from the overburthen of a mass of cases, in which the request and refusal are collusive, and the farce is gone through with in order that the suit may be brought in a Federal court; see, for instance, expressions used in the opinion in *Hawes v. Oakland*.

thority conferred on them by their charter or other source of organization ;

“Or such a fraudulent transaction completed or contemplated by the acting managers, in connection with some other party, or among themselves, or with other shareholders, as will result in serious injury to the corporation, or the interests of the other shareholders ;

“Or where the board of directors, or a majority of them, are acting for their own interest in a manner destructive of the corporation itself, or the rights of other shareholders ;

“Or where the majority of shareholders themselves are oppressively and illegally pursuing a course in the name of the corporation which is in violation of the rights of the other shareholders, and which can only be restrained by the aid of a court of equity.¹

“Possibly other cases may arise in which, to prevent irremediable injury or a total failure of justice, the court would be justified in exercising its powers, but the foregoing may be regarded as an outline of the principles which govern this class of cases.

“But, in addition to the existence of the grievances which call for this kind of relief, it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show to the satisfaction of the court that he has exhausted all the means within his reach to obtain within the corporation itself the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated, effort with the managing body of the corporation, to induce remedial action on their part, and this must be made apparent to the court. If time permits, or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case,

¹ That stockholders may sue under the conditions stated in these last two paragraphs was held in *Barr v. New York, L. E. & W. R. R. Co.*, 96 N. Y. 444 ; *Slatterly v. St. Louis, etc. News Co.*, 91 Mo. 217. See *Sheridan v. Sheridan Electric Light Co.*, 38 Hun (N. Y.) 396.

if this is not done, where it could not be done, or it was not reasonable to require it.”¹

§ 142. The cases hitherto cited are scarcely authority for the proposition that a shareholder, on the improper refusal of the corporation to act, may bring a suit against an outsider on any ordinary right of action pertaining to the corporation, to recover damages for injuries which have already been suffered.² The shareholder must show that he would suffer irremediable loss were he not allowed to bring suit;³ and this will be more difficult to show when the right of action results from past injuries.

Right of shareholder to sue in respect of injuries already accrued.

§ 143. Regarding service of process on corporations, little may be said of general applicability, as this is largely a matter of local practice, regulated in nearly all the states by statutes which designate the mode of ser-

Service of process on corporations.

¹ The doctrines of *Hawes v. Oakland* were approved and reiterated in *Detroit v. Dean*, 106 U. S. 537.

Rule 94 of the Rules of Practice for Courts of Equity of the United States expresses the Federal doctrine. It is as follows:—

“Every bill brought by one or more stockholders in a corporation against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a shareholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it would not otherwise have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees

and, if necessary, of the shareholders, and the causes of his failure to obtain such action.” 104 U. S., IX. See *Quincy v. Steel*, 120 U. S. 241.

² *Samuels v. Central Overland Express Co.*, *McCahon* (Kans.) 214; *S. C.*, under name of *Samuel v. Holladay*, 1 Woolw. 400. Compare *Carter v. Ford Plate Glass Co.*, 85 Ind. 180. Yet this distinction seems questionable. It is disapproved in *City of Chicago v. Cameron*, 120 Ill. 447, 458, in which case the lapse of eleven years was held, under the circumstances, not to constitute laches on the part of the shareholders.

³ See *Detroit v. Dean*, 106 U. S. 537, 542. In general, the English authorities accord with what has been stated in the text: see *Russel v. Wakefield Waterworks Co.*, L. R. 20 Eq. 474; *Gray v. Lewis*, L. R. 8 Ch. 1035; *Foss v. Harbottle*, 2 Hare, 461; *Mozley v. Alston*, 1 Phill. 790. They are more fully discussed in §§ 553–557.

vice and the officer on whom it may be made.¹ A corporation may appear voluntarily by attorney, and such appearance gives jurisdiction to the same extent as actual service of process.² And a corporation may be punished for contempt in disobeying an injunction.³

§ 144. So long as a corporation is not dissolved, the appointment of a receiver of its assets does not prevent bringing suit against it on a cause of action arising from transactions which took place prior to the appointment of the receiver.⁴

Effect of appointment of receiver.

§ 145. The following is a rule of wide application. When a body of men are acting as a corporation under color of apparent organization in pursuance of some charter or enabling act, their legal authority to act as a corporation cannot be questioned collaterally, but only in a direct proceeding in the nature of a *quo warranto*. Under such circumstances, if their organization is irregular, they constitute a corporation *de facto*.⁵ Although this

Corporate franchises cannot be questioned collaterally. General rule.

¹ Service of process on corporations is treated at length in an article by Edwin G. Merriam, in 8 Southern Law Rev. N. S. For a discussion of the validity of service on foreign corporations see §§ 395-399.

² Attorney-General v. Guardian Mutual Ins. Co., 77 N. Y. 272.

³ Golden Gate, etc. M'g Co. v. Superior Court, 65 Cal. 187; compare Hedges v. Superior Court, 67 Cal. 405.

⁴ Pringle v. Woolworth, 90 N. Y. 502; Kincaid v. Dwinelle, 59 N. Y. 548. Suits pending against a corporation are not abated by the appointment of a receiver in the same court. Mercantile Ins. Co. v. Jaynes, 87 Ill. 199; Toledo, W. & N. R. R. Co. v. Beggs, 85 Ill. 80; see Wyatt v. Ohio and Miss. R. R. Co., 10 Ill. App. 289.

⁵ Society Perun v. Cleveland, 43 O. St. 481; Stout v. Zulick, 48 N. J. L. 599, 601. "As against all persons who have entered into contracts with

bodies assuming to act in a corporate capacity, it is sufficient for such bodies to show themselves corporations *de facto*. This cannot be done by showing that they have acted as corporations for any period of time, however long. Two things are necessary to be shown in order to establish the existence of a corporation *de facto*, viz: 1. The existence of a charter, or some law under which a corporation with the powers assumed might lawfully be created; and 2, a user by the party to the suit of the rights claimed to be conferred by such charter or law." Selden, J., in Methodist Episcopal Union Church v. Pickett, 19 N. Y. 482, 485. See Miami Powder Co. v. Hotchkiss, 17 Ill. App. 622. Compare United States Bank v. Stearns, 15 Wend. 314; St. Paul Fire Ins. Co. v. Allis, 24 Minn. 75; DeWitt v. Hastings, 69 N. Y. 518; Factors, etc. Ins. Co. v. New Harbor

general rule is of all but universal applicability when the person seeking to question the validity of the corporate organization is affected with some estoppel arising from his own acts, yet even then it is subject to limitations; and *a fortiori* it is subject to limitations when no such estoppel exists. Its application when there exists an estoppel affecting the party attacking the corporate organization will first be considered.

§ 146. When a body of men have been acting as a corporation *de facto*, under color of apparent organization, and it is sought to hold them to the legal consequences which would have attended their actions, had they been legally organized as a corporation, they will be estopped from denying the legality of their corporate organization.¹ On the other hand, when a person has contracted with such a body as a corporation, he also will be estopped from denying their legal incorporation when sued on his contract.² As Justice Gray said in a recent decision of the

Scope of the rule, when an estoppel affects the case.

Protection Co., 37 La. Ann. 233; Hicks v. Converse, 37 La. Ann. 484; Hudson v. Green Hill Seminary, 113 Ill. 618; Rose Hill, etc. Road Co. v. People, 115 Ill. 133.

¹ Georgia Ice Co. v. Porter, 70 Ga. 637. To a suit on a contract to pay money, or on its note, a corporation cannot plead *nul tiel corporation*. McCulloch v. Talladega Ins. Co., 46 Ala. 376; Empire M'fg Co. v. Stuart, 46 Mich. 482. A corporation by appearing in a suit admits its corporate existence. Missouri River, etc. R. R. Co. v. Shirley, 20 Kans. 660. A corporation is estopped from setting up in defence to an action, the falsity of its certificate of organization or the fact that no certificate had been filed. Dooley v. Cheshire Glass Co., 15 Gray, 494; Merrick v. Reynolds Engine, etc. Co., 101 Mass. 381; Humphrey v. Patrons' Mercantile Ass'n, 50 Iowa, 607; see Hawes v. Anglo-Saxon Petroleum Co., 101 Mass. 385; Kelley v.

Newburyport Horse R. R., 141 Mass. 496. When a corporation accepts a charter from Tennessee, and acts as a Tennessee corporation, it will be estopped, in a suit against it on its obligations, from ousting the jurisdiction of a Federal court by denying its Tennessee citizenship. Blackburn v. Selma M. and M. R. R. Co., 2 Flippin, 525. But see Heinig v. Adams, etc., M'fg Co., 81 Ky. 300.

² Frost v. Frostburg Coal Co., 24 How. 278; French v. Donohue, 29 Minn. 111; Johnston Harvester Co. v. Clark, 30 Minn. 308; Franz v. Teutonia Building Ass'n, 24 Md. 259; Keene v. Van Reuth, 48 Md. 184; Ramsey v. Peoria Marine Ins. Co., 55 Ill. 311; Stoutmore v. Clark, 70 Mo. 471; Studebaker v. Montgomery, 74 Mo. 101; Ryan v. Vanlandingham, 7 Ind. 416; Beatty v. Bartholomew County Agricultural Soc., 76 Ind. 91; Jones v. Kokoma B'ld'g Ass'n, 77 Ind. 340; Smelser v. Wayne Turn-

Supreme Court of the United States:¹ "One who deals with a corporation as existing in fact, is estopped to deny as against the corporation that it has been legally organized." Or as Judge Cooley expressed the same principle more at length in *Swartwout v. Michigan Air Line Railroad Co.*:² "Where there is thus a corporation *de facto* with no want of legislative power to its due and legal existence; where it is proceeding in the performance of corporate functions, and the public are dealing with it on the supposition that it is what it professes to be, and the questions suggested are only whether there has been exact regularity and strict compliance with the provisions of the law relating to incorporation; it is plainly a dictate of justice and of public policy, that in controversies between the *de facto* corporation and those who have entered into contract relations with it, as incorporators or otherwise, such questions should not be suffered to be raised."³

§ 147. Consequently, fraud in obtaining the charter of a corporation cannot be interposed as a defence by one of its debtors.⁴

pike Co., 82 Ind. 417; *Jones v. Cincinnati Type Foundry Co.*, 14 Ind. 89; *Butchers and Drovers' Bank v. McDonald*, 130 Mass. 264; *Spahr v. Farmers' Bank*, 94 Pa. St. 429; *Jones v. Bank of Tennessee*, 8 B. Mon. (Ky.) 122; *Cahill v. Citizens Mut. B'd'g Ass'n*, 61 Ala. 232; *Imboden v. Etowah*, etc. M'g Co., 70 Ga. 86. Compare *Brown v. Mortgage Co.*, 110 Ill. 235; *Hudson v. Green Hill Seminary*, 113 Ill. 618; *Town of Searcy v. Yarnell*, 47 Ark. 269. A person who has conveyed land to a corporation is estopped from suing to recover it on the ground that at the time of his conveyance the corporation had not been duly organized, and so was incapable of taking. *Baker v. Neff*, 73 Ind. 68. These principles are embodied in a statute in Iowa Code, § 1089; see *Carrothers v. Newton Spring Co.*, 61 Iowa, 681.

¹ *Close v. Glenwood Cemetery*, 107 U. S. 466.

² 24 Mich., 389, 393.

³ See also *City of St. Louis v. Shields*, 62 Mo. 247; *Boise City Canal Co. v. Pinkham*, 1 Idaho, 790; *Goodrich v. Reynolds*, 31 Ill. 490; *German Ins. Co. v. Strahl*, 13 Phila. 512; *Merchants & Planters' Line v. Waganer*, 71 Ala. 581.

Contracting with a corporation under its amended charter, by the name which the amended charter authorized it to take, estops a person from denying the acceptance of the amendment. *Eppes v. Miss.*, Gainesville, etc. R. R. Co., 35 Ala. 33. A person claiming title under a deed which recites that it is subject to a mortgage to a corporation, is estopped from questioning the legal organization of such corporation. *Hasenritter v. Kirchhoffer*, 79 Mo. 239.

⁴ *Pattison v. Albany Building Ass'n*, 63 Ga. 373; *Kishacoquillas, etc. Trunpike Co. v. McConaby*, 16 S. & R. (Penn.) 140; *Kayser v. Trustees, of*

Nor can a subscriber when sued on his subscription for stock in a *de facto* corporation deny its legal incorporation, or allege that it has done acts forfeiting its franchises.¹

§ 148. Further, persons who have contracted with a corporation as such, and have thus acquired claims against it, are estopped from denying its corporate existence for the purpose of holding its shareholders liable as partners.² This last proposition, however, does not hold where the enabling act under which the corporation is formed expressly provides, or by the general tenor of its terms clearly indicates that the shareholders shall receive no protection from their organization unless the requirements of the act are fully complied with.³ Nor does it hold where the authority under which the would-be shareholders have attempted to form themselves into a corporation is no authority at all, so that their organization never had even the appearance of validity: as if, for instance, a body of men in New Jersey should attempt to form themselves into a corporation under the laws of New York.⁴ Such a body would not constitute a *de facto* corporation.

Bremen, 16 Mo. 88. But only on *quo warranto*. Charles River Bridge v. Warren Bridge, 7 Pick. 344; see Aurora, etc. R. R. Co. v. Lawrenceburgh, 56 Ind. 80.

¹ Chubb v. Upton, 95 U. S. 665; Slocum v. Providence Steam & Gas Pipe Co., 10 R. I. 112; Freeland v. Pennsylvania Central Ins. Co., 94 Pa. St. 504; compare Swartwout v. Michigan Air Line Co., 24 Mich. 389; Toledo and Ann Arbor R. R. Co. v. Johnson, 49 Mich. 148; and see in detail with full authorities, §§ 537-539, 738, 739.

² Fay v. Noble, 7 Cush. 188; Trowbridge v. Scudder, 11 Cush. 83; First Nat. Bk. v. Almy, 117 Mass. 476; Humphreys v. Mooney, 5 Colorado, 282; Merchants and Manufacturers' Bk. v. Stone, 38 Mich. 779; Second Nat. Bk. v. Hall, 35 Ohio St. 158;

Planters, etc. Bank v. Padgett, 69 Ga. 159; Stout v. Zulich, 48 N. J. L. 599. See New York Iron Mine v. First Nat. Bk., 39 Mich. 644; Stafford Nat. Bk. v. Palmer, 47 Conn. 443. See § 739.

³ See Singer v. Given, 61 Iowa, 93; Marshall v. Harris, 55 Iowa, 182; Eisfeld v. Kenworth, 50 Iowa, 389; Kaiser v. Lawrence Savings Bk., 56 Iowa, 104; Garnett v. Richardson, 35 Ark. 145; Ferris v. Thaw, 72 Mo. 446. See Smith v. Colorado Fire Ins. Co., 14 Fed. Rep. 399.

⁴ Hill v. Beach, 12 N. J. Eq. 31. Compare Methodist Episcopal Church v. Pickett, 19 N. Y. 483, 485; Lewis v. Tilton, 64 Iowa, 220. A corporation organized under a void law cannot enforce a mortgage made to it. But, if not organized for an unlawful purpose, its receiver can demand an

§ 149. The foregoing rules as resting on principles of estoppel, are subject to still further qualifications.¹ The principle of estoppel cannot be carried so far as to bar the plea that the contract on which suit is brought is illegal; *malum prohibitum* or *malum in se*; for, from motives of public policy the law will not lend itself to enforce such a contract.² Likewise the law will not aid an illegal enterprise by enforcing a contract at the suit of a corporation incorporated for an illegal purpose.³ If, however, there is nothing illegal in the purposes for which a corporation has been formed, the illegal nature of the *de facto* legislature that incorporated or purported to incorporate it will not so infect it with illegality as to render it incapable of suing in its corporate name.⁴

§ 150. As a final and obvious limitation on these rules as resting on estoppel, it must appear that there is an estoppel affecting the party who would deny the corporate existence. As was said in *Doyle v. Mizner*:⁵ "There are certainly many cases in which a recognition of corporate existence by dealing with the corporation will estop from questioning it. But this doctrine rests on the ground that such action creates relations and encourages conduct which there may be difficulty in un-

accounting for the debt in a court of equity. *Burton v. Schildbach*, 45 Mich. 504.

¹ An estoppel cannot be relied on in the face of a statute. Thus where the civil code prescribes that an unauthorized corporation cannot appear in court, a defendant may plead that the corporation cannot sue. *Workingmen's Bank v. Converse*, 29 La. Ann. 369; see *Nat. B'k v. Phoenix Warehousing Co.*, 6 Hun, 71.

² See §§ 297 *et seq.*

³ *Detroit Schuetzen Bund v. Detroit Agitations Verein*, 44 Mich. 313. A shareholder is not estopped by his subscription from denying the lawful existence of a corporation prohibited by the state constitution. *St. Louis Colonization Ass'n v. Hennessy*, 11 Mo.

App. 555; see also *Chicora Co. v. Crews*, 6 S. C. 243, and, *semble contra*, *Importing and Exporting Co. v. Locke*, 50 Ala. 332.

⁴ *United States v. Insurance Cos.*, 22 Wall. 99.

⁵ 42 Mich. 332, 336. See also *Mansfield, etc. R. R. Co. v. Drinker*, 30 Mich. 124. After the charter has expired a person is not estopped from pleading *nul tiel corporation* to a suit brought by the defunct corporation. The action must be brought in some other manner. *Krutz v. Paola Town Co.*, 20 Kans. 297; *contra* *St. Louis Gas Light Co. v. St. Louis*, 11 Mo. App. 55; *aff'd* 84 Mo. 202. Compare *Brooklyn Steam Transit Co. v. Brooklyn*, 78 N. Y. 524; *Newton M'f'g Co. v. White*, 42 Ga. 148.

doing. In ordinary cases such recognitions have been considered as binding. But this rule is one originating in equitable principles, and cannot be applied universally. There would be no sense in applying it where no new rights have intervened, and where such recognition has itself been brought about by fraudulent dealing carried on for the very purpose of entrapping a party into the action on which such recognition is rested. If there was no corporation in fact, and if there are no facts which make it legally unjust to permit its denial, it is difficult to understand what room there is for an estoppel."

§ 151. The application of the general rule against collateral attacks on corporate franchises to cases where there is no estoppel affecting the person seeking to impugn them, may now be considered. Under such circumstances the rule applies whenever one or both of the following reasons hold good. The first reason lies in the obvious principle that a person to be entitled to maintain a legal proceeding questioning the rights, immunities, or privileges of others, must himself have some title or legal or equitable interest in the subject in regard to which the rights, privileges, or immunities exist. Otherwise he has no standing in court.¹ When one man is exercising a right of way over another's land, a third person with no interest in the land cannot maintain an action to try the validity of the right of way, for in plain English it is none of his business. Likewise, the question whether a body of men acting as a corporation are legally incorporated, is not the affair of a person whose rights are in no way affected. That a body of men shall not without due incorporation act as a body corporate is undoubtedly public policy. Accordingly, any one may bring the matter to the attention of the attorney-general, who, on receiving the information, may institute, on behalf of the state, a proceeding in the nature of a *quo warranto*. But a private person cannot do this in his own name.²

Scope of
the rule
when no
estoppel
exists.

¹ A junior mortgagee cannot defeat the rights of a senior mortgagee, a corporation, by setting up defects in the latter's organization. *Williamson v. Kokomo B'ldg Ass'n*, 89 Ind. 389. See § 146 and note.

² The charter of a corporation can be forfeited only at the suit of the state. *Louisiana Savings Bank, Matter of*, 35 La. Ann. 196; *North v. State*, 107 Ind. 356.

A case well illustrating the hardship and injustice which might result could any one at his will impugn the legality of corporate organization, is that of the Cincinnati, Lafayette, etc. Railroad Co. *v.* Danville and Vincennes Railway Co.¹ The defendant corporation, relying on technical defects in the organization of the plaintiff, had instituted proceedings to acquire, by virtue of defendant's delegated right of eminent domain, the land on which the plaintiff's road was built, and in these proceedings had entirely ignored the plaintiff and its right of way, acquired by purchase over this land, the defendant's hope being thus to avoid making compensation to the plaintiff for the plaintiff's right of way. The plaintiff brought suit to restrain these proceedings, and the court sustained the action, holding that, notwithstanding the plaintiff's defective organization, the defendant could not appropriate its property without making compensation.

§ 152. Accordingly, where two railroad companies have each authority to build and run a railroad between the same termini, neither can take exceptions to any irregularity in the exercise of the other's franchises, unless it can show a particular injury to itself.² If, however, a railroad company is chartered with the exclusive right to build a railroad between two given points, it may enjoin another company, possessing no adequate and constitutional authority, from building a road between the same points.³ Likewise, where a street railway company has the right that no other parallel railway shall be built within

¹ 75 Ill. 113. Compare *Union Branch R. R. Co. v. East Tenn., etc. R. R. Co.*, 14 Ga. 327.

² *Erie R'y Co. v. Delaware, L. & W. R. R. Co.*, 21 N. J. Eq. 283. See *West Jersey R. R. Co. v. Cape May, etc. R. R. Co.*, 34 N. J. Eq. 164; *Market St. R'y Co. v. Central R'y Co.*, 51 Cal. 583.

A chartered turnpike company has no right of action against a railroad company subsequently chartered to run between the same termini and along the same line of travel for di-

verting its custom. *Washington, etc. T. Road v. Baltimore & O. R. R. Co.*, 10 G. & J. (Md.) 392; *White River T. Co. v. Vermont Central R. R. Co.*, 21 Vt. 590; *Thorpe v. Rutland & B. R. R. Co.*, 27 Vt. 140, 152. See § 453.

³ *Raritan & D. B. R. R. Co. v. Delaware, etc. Canal Co.*, 18 N. J. Eq. 546; *Boston & L. R. R. Co. v. Salem, etc. R. R. Co.*, 2 Gray (Mass.), 1; *Pontchartrain R. R. Co. v. New Orleans, etc. R. R. Co.*, 11 La. Ann. 253.

three blocks, it may enjoin an invasion of its rights without further proof of damage than that its right is invaded.¹

§ 153. The second reason why a person, although affected by no estoppel, may not collaterally question the validity of corporate franchises lies in the great hardship to which corporations would be subject if they could be forced in any proceeding, in order to enforce their rights, to prove the absolute legal regularity of their organization. And thus it is, that only in a direct proceeding brought in proper form to test the validity of its franchises, or in a proceeding where the corporation is itself seeking to exercise a special franchise, which the other party denies to exist, or which the corporation is entitled to exercise only by virtue of its regular and complete organization, can the corporation be compelled to prove anything more than a *de facto* organization.

Mackall v. Chesapeake, etc. Canal Co.² is an instructive case in point. There the property of the canal company, by its charter exempted from taxation, had been sold under a tax sale, and the purchaser, to sustain the validity of the sale, pleaded that the company had forfeited its privileges. But the court held, that the question of the company's forfeiture of its rights to hold, free from taxation, property no longer in use for canal purposes, could be judicially determined only in a direct proceeding by the public authorities, and could not be made an issue for the first time in the trial of a question of private right between the company and a purchaser under a tax sale.³

¹ St. Louis R. R. Co. v. Northwestern St. L. R'y Co., 69 Mo. 65. Such exclusive franchises are of course to be construed strictly against the grantee; see Louisville & P. R. R. Co. v. Louisville City R'y Co., 2 Duv. (Ky.) 175, and § 453; and may be taken by eminent domain. See § 470.

² 94 U. S., 308.

³ See also Toledo and Ann Arbor R. R. Co. v. Johnson, 49 Mich. 148; Osborn v. People, 103 Ill. 224; New Jersey Southern R. R. Co. v. Long

Branch Commissioners, 39 N. J. L. 28; Truckee, etc. Turnpike Co. v. Campbell, 44 Cal. 89; Freeland v. Pennsylvania Central Ins. Co., 94 Pa. St. 504, 513; Keene v. Van Reuth, 48 Md. 184; Denver and Swansea R'y Co. v. Denver City R'y Co., 2 Col. 673; Montgomery v. Merrill, 18 Mich. 339, 343; Hackensack Water Co. v. De Kay, 36 N. J. Eq. 548; Association v. Fenner, 13 Phila. 107; Pixley v. Roanoke Nav. Co., 75 Va. 320; Lagrange, etc. R. R. Co. v.

§ 154. It is evident that no reason heretofore stated for the rule against allowing collateral attacks on corporate franchises, applies where the corporation is seeking to enforce against a person affected by no estoppel some right which the corporation possesses only by virtue of its regular and legal organization; for in such cases the legal, not the *de facto*, organization of the corporation forms the basis of its rights, and there is no hardship in putting the corporation to the proof of the validity of its franchises, when it is itself in the same proceeding basing its right directly on them.

Thus, in a Michigan case, a subscription had been made to the stock of a certain railroad company, and subsequently from this company and others a consolidated company was formed. The consolidated company then brought suit to recover the subscription, basing its action on its succession, under the statute authorizing the consolidation, to the rights of the former companies; and the court allowed the plea, that the consolidated company had not complied with the terms of the statute under which it had been formed.¹

§ 155. Again, on the regular incorporation and continuing validity of the franchise of a railroad company depends its right by the delegated power of eminent domain to take property for its use. Accordingly, if by non-fulfilment of conditions in its charter, the corporation has forfeited its franchises, this may be pleaded by any one whose property the corporation is seeking to condemn.² And in a proceeding to condemn land for a railroad, a landowner may deny, and thus force the corporation to prove, its due legal incorporation.³

Rainey, 7 Coldw. (Tenn.) 420; and compare *Schulenberg v. Harriman*, 21 Wall. 44; *Van Wyck v. Knevals*, 106 U. S. 360.

A plea to an action brought by a corporation, that it has forfeited its charter, is demurrable, unless a judicial declaration of the forfeiture is alleged. *West v. Carolina Life Ins. Co.*, 31 Ark. 476; *Logan v. Vernon*, etc. R. R. Co., 90 Ind. 552; see § 432.

¹ *Mansfield, etc. R. R. Co. v. Drinker*, 30 Mich. 124. The subscriber had done no acts recognizing the consolidated company, and so was affected by no estoppel. See also *New Orleans Gas Light Co. v. Louisiana Light, etc. Co.*, 11 Fed. Rep. 277. Compare *Deaderick v. Wilson*, 8 Bax. (Tenn.) 108, 128.

² *Matter of Brooklyn, W. and N. Railway Co.*, 72 N. Y. 245; see § 166.

³ *Powers v. Hazleton, etc. R'y Co.*,

§ 156. Likewise a person, affected by no estoppel, against whom a special separately granted franchise is sought to be exercised, may, without questioning the general validity of the corporate organization, deny the right of the company to exercise that particular franchise. Thus, a corporation was organized to construct a bridge over a navigable stream, and by distinct action on the part of the county supervisors received the franchise to take tolls for twenty years. It was held that a person sued for tolls, could plead that its right to demand them had expired by the lapse of the twenty years.¹

§ 157. If a corporation is defectively organized at the beginning, legislative recognition of it as a corporation will cure the defects;² which often may be cured by proper measures taken on the part of the corporation.³

Defective
organiza-
tion re-
mediable.

§ 158. It may be mentioned here that even where there is no statute forbidding the formation of corporations with names similar to those of corporations already in existence,⁴ a corporation will be protected in

Right to
corporate
name.

33 Ohio St. 429; *Atkinson v. Marietta*, etc. R. R. Co., 15 O. St. 21. Contra, *McAuley v. Columbus*, Chicago, etc. R'y Co., 83 Ill. 348; *Peoria & P. W. R'y Co. v. Peoria & F. R'y Co.*, 105 Ill. 110; *Reisner v. Strong*, 24 Kan. 410; *Schroeder v. Detroit*, etc. R'y Co., 44 Mich. 387. Compare *Buncombe Turnpike Co. v. McCarron*, 1 Dev. & Bat. (N. C.) Law, 306; *Farham v. Delaware and Hudson Canal Co.*, 61 Pa. St. 265; *National Docks R. R. Co. v. Central R. R. Co.*, 32 N. J. Eq. 755. A court of equity will enjoin a railroad company improperly and fraudulently organized from condemning land. *Niemeyer v. Little Rock*, etc. R'y Co., 43 Ark. 111. Compare *East & West R. R. Co. v. East Tennessee*, etc. R. R. Co., 75 Ala. 275.

¹ *Grand Rapids Bridge Co. v. Prange*, 35 Mich. 400. See *Denver and Swancy R'y Co. v. Denver City*

R'y Co., 2 Col. 673. Compare *Truckee*, etc. Turnpike Co. v. *Campbell*, 44 Cal. 89; *Pixley v. Roanoke Navigation Co.*, 75 Va. 320; *Attorney-General v. Utica Ins. Co.*; 2 Johns. Ch. 371.

² *Kanawha Coal Co. v. Kanawha and Ohio Coal Co.*, 7 Blatchf. 391; *Basshor v. Dressel*, 34 Md. 503; *People v. Perrin*, 56 Cal. 345; *White v. Coventry*, 29 Barb. 305; *Cochran v. Arnold*, 58 Pa. St. 399. A statute curing the defects in the organization of a *de facto* corporation is not repugnant to a constitutional provision prohibiting the creation of corporations by special act. *Central Agricultural Ass'n v. Alabama Gold Life Ins. Co.*, 70 Ala. 120.

³ See *Augur Steel Axle*, etc. Co. v. *Whittier*, 117 Mass. 451.

⁴ See, *e. g.*, *New York Laws of 1875*, chap. 611, § 4.

the exclusive use of its name;¹ especially when its name designates the nature of the goods which it manufactures.² A corporation has no implied power to change its name;³ though it would seem that a corporation may acquire a name by usage or reputation,⁴ and may even have more names than one.⁵

§ 159. The misnomer of a corporation in contracting or pleading has an effect similar to the misnomer of an individual. If, from the body of a written contract in which a corporation is misnamed, the corporation intended can be ascertained, the misnomer is immaterial.⁶ Where this cannot be done, parol evidence may be introduced under proper averments in the pleadings.⁷

§ 160. The powers more especially incident or usual with certain important classes of corporations may now be spoken of.

¹ In Tennessee a petition to change for incorporation may be opposed if the proposed name for the corporation is similar to that of an existing corporation; and the court may require the name to be modified. *Ex parte Walker*, 1 Tenn. Ch. 97. Compare *Drummond Tobacco Co. v. Randle*, 114 Ill. 412; *In re First Presbyterian Church*, 111 Pa. St. 156.

² *Holmes v. Holmes M'fg Co.*, 37 Conn. 278; compare *Newby v. Oregon Cent. R. R. Co.*, Deady, 609; see § 137.

³ See *Reg. v. Registrar, etc.*, 10 Q. B. 839. But where the name of a corporation is changed by the legislature, and by its new name it is made the successor of all the rights and liabilities of its former self, it may under the new name sue on a note made to it under the old name; although the note is not indorsed. *Trustees of Northwestern College v. Schwagler*, 37 Iowa, 577.

⁴ *Smith v. Plank Road Co.*, 30 Ala. 650; *Dutch West India Co. v. Van*

Moses, 1 Stra. 612, 614; *South School District v. Blakeslee*, 13 Conn. 227.

⁵ *Minot v. Curtis*, 7 Mass. 441; *Knight v. Mayor of Wells*, 1 Ld. Raym. 80.

⁶ *Ryan v. Martin*, 91 N. C. 464; *Asheville Division v. Aston*, 92 N. C. 578. See *Hoboken Building Association v. Martin*, 13 N. J. Eq. 427; *Boisgerard v. New York Banking Co.*, 2 Sandf. Ch. 23; *Mott v. Hicks*, 1 Cowen, 513; *Brockway v. Allen*, 17 Wend. 40. When a deed is made to a corporation under a name varying from its true one, the corporation may sue in its true name, averring that the defendant made the deed to it under the name mentioned in the deed. *Northwestern Distilling Co. v. Brant*, 69 Ill. 658.

⁷ *Medway Cotton M'fg Co. v. Adams*, 10 Mass. 360; *Melledge v. Boston Iron Co.*, 5 Cush. 158; *Berks, etc. Turnpike Co. v. Myers*, 6 S. & R. 12; *Milford, etc. Turnpike Co. v. Brush*, 10 Ohio, 111.

§ 161. To banking corporations¹ the powers to loan money and take security therefor,² to deal in exchange, purchase, discount³ and collect⁴ notes and bills, and to receive deposits are incidental.⁵ An ordinary bank has incidentally the power as gratuitous bailee to receive a special deposit for safe keeping; and, as the enumeration of banking powers in the National Banking Act is not an enumeration of incidental powers, and places no special restriction on national banks in this respect, a national bank may receive a special deposit, and will be liable for its loss occurring through gross negligence attributable to the bank.⁶ It has

Powers of
banking
corpora-
tions.

¹ The right of banking is a common law right; but in New York, since the restraining act of 1804, it has become a franchise exercisable only by persons authorized by the legislature. *People v. Utica Ins. Co.*, 15 Johns. 358.

² A national bank may loan on negotiable notes secured by collateral. *Shoemaker v. National Mechanics' Bank*; 1 Hughes, 101. It may take a chattel mortgage to secure a previously contracted debt. *Spafford v. First Nat. Bank*, 37 Iowa, 181. It may receive stocks and bonds as collateral to secure present as well as future indebtedness; and will be liable when such collateral is stolen through its lack of reasonable care; even where the collateral remains in its custody after the debt is discharged. *Third Nat. Bk. v. Boyd*, 44 Md. 47. As to the liability of a bank on the certifications and accommodation indorsements of its officers, see §§ 242-245. A bank has implied power to borrow money. *Donnell v. Lewis County S'v'gs Bk.*, 80 Mo. 165.

³ *Smith v. Exchange Bank*, 26 Ohio St. 141; *Atlantic State Bank v. Savery*, 18 Hun, 36.

⁴ As to the liability of banks in making collections for the misfeasance

of notaries and correspondent banks see *Exchange Nat. Bk. v. Third Nat. Bk.*, 112 U. S. 276; *Davey v. Jones*, 42 N. J. L. 28; *Ayrault v. Pacific Bank*, 47 N. Y. 570; *Bank of New Hanover v. Kenan*, 76 N. C. 340; *Angell and Ames on Corp.*, §§ 249 *et seq.*; *Morse on Banking*, second ed., ch. 6.

⁵ In regard to the relations between a bank and its depositors, see §§ 672, 673.

⁶ *National Bank v. Graham*, 100 U. S. 699; *Wylie v. Northampton Bank*, 119 U. S. 361; *Pattison v. Syracuse Nat. Bank*, 80 N. Y. 82. But only if the loss occur through *gross* negligence. *First Nat. Bank v. Rex*, 89 Pa. St. 308; *Lloyd v. West Branch Bank*, 15 Pa. St. 172. In *Bank v. Gent*, 39 O. St. 105, it was held that a national bank is liable for the loss of a special deposit "occurring through the want of that degree of care which good business men would exercise in keeping property of such value." That the safe of a national bank is broken and bonds stolen by burglars is not evidence of negligence. *Wylie v. Northampton Bank*, 119 U. S. 361; *First Nat. Bank v. Graham*, 79 Pa. St. 106. But see *Wiley v. First Nat.*

further been held within the powers of a bank to receive a deposit under an agreement to hold it as collateral security for the performance of a contract between the depositor and a third person.¹

A national bank may lawfully engage in the business of exchanging and dealing in government securities;² but not in that of dealing in stocks,³ or selling railroad bonds on commission.⁴ Nor is it within the powers of a state bank to subscribe for the stock of a railroad corporation.⁵ Any bank may assign or convey property owned by it, and enter into the common covenants of warranty.⁶ And a national bank in selling real estate competently acquired by it, may take back a purchase-money mortgage.⁷

§ 162. In regard to railroad companies, the only capacities requiring mention here,⁸ are their powers to locate and construct their roads, and the power ordinarily granted to them to take property by compulsory process, there being delegated to them for this purpose a limited special right of eminent domain.

Powers of
railroad
corpora-
tions.
Eminent
domain.

Bank, 47 Vt. 546; *Whitney v. Same*, 50 Vt. 388; S. C., 55 Vt. 154; *First Nat. Bank v. Ocean Nat. Bank*, 60 N. Y. 278; and compare *Foster v. Essex Bank*, 17 Mass. 479; *Comp v. Carlisle Deposit Bank*, 94 Pa. St. 409. In *Greeley v. Nashua Savings Bank*, 63 N. H. 145, the (savings) bank was held not to be liable for bonds received by its clerk on its behalf, there being no further proof that the bonds or their proceeds had come into its possession. See also § 337.

¹ *Bushnell v. Chautauqua County Nat. Bank*, 74 N. Y. 290.

² *Van Leuven v. First Nat. Bank*, 54 N. Y. 671; *Yerkes v. Nat. Bank*, 69 N. Y. 382.

³ *First Nat. Bank v. Nat. Exchange Bank*, 92 U. S. 122.

⁴ *Weckler v. First Nat. Bank*, 42 Md. 581; *First Nat. Bank v. Hoch*, 89 Pa. St. 324.

⁵ *Nassau Bank v. Jones*, 95 N. Y. 115; see § 130, note.

⁶ *Talman v. Rochester City Bank*, 18 Barb. 123.

⁷ *New Orleans Nat. Bank v. Raymond*, 29 La. Ann. 355. Unauthorized conveyances and mortgages to a national bank are valid for all purposes until questioned by the United States. *National Bank v. Matthews*, 98 U. S. 621; *Mapes v. Scott*, 94 Ill. 379; *Winton v. Little*, 94 Pa. St. 64; *Oldham v. First Nat. Bank*, 85 N. C. 240; see § 303.

⁸ As to the power of railroad companies to enter into traffic arrangements, or give special facilities to certain customers, see §§ 308, 309. For their liability as carriers, see §§ 347 *et seq.*

In the ordinary course of its business, a railroad company may take and negotiate a promissory note. *Goodrich v. Reynolds*, 31 Ill. 490.

When, within certain limits, the course and manner of constructing a railroad are entrusted to the railroad company, or to railroad commissioners, their discretion will not be controlled or revised by a court so long as they act in good faith and within their powers.¹ A court of equity will not interfere to control the location of a railroad where the corporation has exercised within the prescribed termini of its route its accorded discretion;² the court will not interfere, for instance, on the ground that another site would better subserve public interests.³ But a railroad company is not justified in sacrificing the public interest to its own advantage, and must regard the interests of the public in locating its route and stations. Failing in this, it cannot be regarded as acting in good faith. Accordingly, on grounds of public policy, contracts to locate a station at a certain spot, coupled with an agreement to establish no other stations in the same vicinity, are void.⁴ Ordinarily, however, a railroad company may use its discretion in locating its stations, as it may in selecting its route, and, for instance, is not bound to stop at the junction of a connecting road, and there interchange business, although it may have established joint depot accommodations with another company elsewhere.⁵

¹ Fall River Iron Works Co. v. Old Colony, etc. R. R. Co., 5 Allen (Mass.), 221; Mayor, etc. of Worcester v. Railroad Commissioners, 113 Mass. 161, 171; New York H. & N. R. R. Co. v. Boston H. & E. R. R. Co., 36 Conn. 196, 201.

² Southern Minnesota R. R. Co. v. Stoddard, 6 Minn. 150; Walker v. Mad River & L. E. R. R. Co., 8 Ohio, 38.

³ Parke's Appeal, 64 Pa. St. 137; Anspach v. Mahanoy, etc. R. R. Co., 5 Phila. (Penn.) 491.

⁴ Texas & St. L. R. R. Co. v. Robards, 60 Tex. 545; St. Louis J. & C. R. R. Co. v. Mathers, 104 Ill. 257; S. C., 71 Ill. 592; St. Joseph & D. R. R. Co. v. Ryan, 11 Kan. 602; Pacific R. R. Co. v. Seely, 45 Mo. 212; Fuller v. Doane, 18 Pick. (Mass.) 472;

Bestor v. Wathen, 60 Ill. 138; Linder v. Carpenter, 62 Ill. 309; Marsh v. Fairbury, etc., R. R. Co., 64 Ill. 414; Holladay v. Patterson, 5 Oreg. 177; compare Harris v. Roberts, 12 Neb. 631; Wooters v. International & G. N. R. R. Co., 54 Tex. 294; Cleveland C. C. & I. Ry. Co. v. Coburn, 91 Ind. 557; Workman v. Campbell, 46 Mo. 305; Berryman v. Cincinnati Southern R. R. Co., 14 Bush (Ky.), 755. But see Cedar Rapids, etc. Ry. Co. v. Spofford, 41 Iowa, 292; First Nat. Bank v. Hendrie, 49 Iowa, 402.

⁵ Atchinson T. & S. F. R. R. Co. v. Denver & N. O. R. R. Co., 110 U. S. 667. See also Martindale v. Kansas City, St. Jo. & C. B. R. R. Co., 60 Mo. 508; Kinealy v. St. Louis K. C. & N. Ry. Co., 69 Mo. 658.

§ 162 *a.* After a railroad company has once located and built its track, it has no power to change the location materially,¹ unless a statute give it special authority.² It can never be presumed that a legislature will pass a law to the detriment of the public; but it does not follow that from oversight or ignorance of the full circumstances a law may not have been passed which might be improved by amendment. Consequently a contract by a railroad company, conditioned on its receiving power from the legislature to change the location of its road, is not invalid as against public policy.³

When a railroad company has located its road and obtained title to the land, either the fee or the requisite easement, the mode of occupation and degree of exclusiveness necessary and proper for the convenient use of its functions are within its discretion.⁴ Nevertheless, when it takes but an easement, sufficient interest remains in the owner of the fee to prevent the railroad company from extending its use beyond the reasonable terms of its easement, since that would be an encroachment on his residuary rights.⁵

An unrestricted grant to a railroad company of power to construct a road between two points, carries with it the right to cross navigable waters, if they intervene in a course or route which is otherwise proper, and the road can be constructed over

¹ Little Miami R. R. Co. *v.* Naylor, 2 O. St. 235; *Wirth v. Philadelphia City Pass'r Ry. Co.*, 2 Weekly Notes of Cases (Penn.), 650; *Brigham v. Agricultural Branch R. R. Co.*, 1 Allen (Mass.), 316; *State v. New Haven & N. Co.*, 45 Conn. 331. But compare *Mahaska County R. R. Co. v. Des Moines Valley R. R. Co.*, 28 Iowa, 437; *Gear v. Dubuque & S. C. R. R. Co.*, 20 Iowa, 523; *Hestonville, etc. R. R. Co. v. Philadelphia*, 89 Pa. St. 210.

² See *Toledo & U. Ry. Co. v. Daniels*, 16 O. St. 390; *Atkinson v. Marietta & C. R. R. Co.*, 15 O. St. 21; *Matter of New York L. & W. Ry. Co.*, 88 N. Y. 279.

³ *Supervisors v. Wisconsin Central R. R. Co.*, 121 Mass. 460; *New Haven & Northampton Co. v. Hayden*, 107 Mass. 525; see § 305, last note.

⁴ *Brainard v. Clapp*, 10 Cush. (Mass.) 6; *Hagen v. Boston & M. R. R. Co.*, 2 Gray (Mass.), 577, 580; see *Prather v. Western Un. Tel. Co.*, 89 Ind. 501. See § 165.

⁵ See *Proprietors of Locks and Canals v. Nashua & L. R. R. Co.*, 104 Mass. 1; *Aldrich v. Drury*, 8 R. I. 554; *Blake v. Rich*, 34 N. H. 282; *Chapin v. Sullivan R. R. Co.*, 39 N. H. 564; *Jessup v. Loucks*, 55 Pa. St. 350.

them without destroying the public easement or seriously impairing it.¹

§ 163. The legislature cannot authorize the taking of private property for private use, even on just compensation.² Moreover, the determination by the legislature that a purpose for which it directs private property to be taken is a public purpose is not conclusive, but open for determination by the courts; although if the use be public, legislative decision is conclusive as to the public exigency requiring the property to be taken.³

The following uses have been held public purposes for which the legislature may delegate to a private corporation the power to take private property: to supply a village with wholesome water;⁴ build a bridge which by the same statute is declared a public highway;⁵ develop the mineral resources of the state;⁶ build (public) telegraph lines;⁷ build and operate a railroad as a common carrier.⁸ No matter how apparently necessary to a

¹ *Miller v. Prairie du Chien, etc. Ry. Co.*, 34 Wis. 533; *Fall River Iron Works Co. v. Old Colony, etc. R. R. Co.*, 5 Allen (Mass.), 221; *Hamilton v. Vicksburg S. & P. R. R. Co.*, 34 La. Ann. 970. See § 163a for the taking by a railroad company of land already devoted to a public use, as a street or another railroad.

² *Matter of Eureka Basin, etc. Co.*, 96 N. Y. 42; *Lorenz v. Jacob*, 63 Cal. 73; *Scudder v. Trenton Delaware Falls Co.*, Saxton (N. J.), 695. *Contra, Costa Coal Mines R. R. Co. v. Moss*, 23 Cal. 323; *Consolidated Channel Co. v. Central Pacific R. R. Co.*, 51 Cal. 269; *Sadler v. Langham*, 34 Ala. 311; *County Court v. Griswold*, 58 Mo. 175; *Palairot's Appeal*, 67 Pa. St. 479. *Contra, Harvey v. Thomas*, 10 Watts (Pa.), 63.

³ *Talbot v. Hudson*, 16 Gray (Mass.), 417; *Chicago R. I. & P. R. R. Co. v. Town of Lake*, 71 Ill. 333; *Sadler v. Langham*, 34 Ala. 311; *County Court v. Griswold*, 58 Mo. 175; *Concord R.*

R. v. Greely, 17 N. H. 47; *Baltimore & O. R. R. Co. v. Pittsburgh W. & K. R. R. Co.*, 17 W. Va. 812.

See *Boston Water Power Co. v. Boston & W. R. R. Co.*, 23 Pick. (Mass.) 360; *Riche v. Bar Harbor Water Co.*, 75 Me. 91; *Tidewater Co. v. Coster*, 18 N. J. Eq. 518; *National Docks R. R. Co. v. Central R. R. Co.*, 32 N. J. Eq. 755.

But see *Prather v. Jeffersonville M. & I. R. R. Co.*, 52 Ind. 16; *Mims v. Macon & W. R. R. Co.*, 3 Ga. 333, 338.

⁴ *Riche v. Bar Harbor Water Co.*, 75 Me. 91.

⁵ *Arnold v. Covington Bridge Co.*, 1 Duv. (Ky.) 372.

⁶ *Hand Gold M'g Co. v. Parker*, 59 Ga. 419 (perhaps extreme).

⁷ *New Orleans, etc. R. R. Co. v. Southern, etc. Telegraph Co.*, 53 Ala. 211.

⁸ *National Docks R. R. Co. v. Central R. R. Co.*, 32 N. J. Eq., 755; *Bloodgood v. Mohawk & H. R. R. Co.*,

corporation the right of eminent domain may be to enable it to fulfil its corporate purposes, the possession of this right can never be implied or presumed; and express authority for its exercise must always be shown.¹ The right of eminent domain of a railroad company, moreover, extends only to property reasonably necessary to enable it to fulfil the purposes of its incorporation.²

When the legislature has not declared that the property sought to be condemned is necessary for the company, such necessity, if contested, is a question for the court; for the determination of the company in this matter is not conclusive;³ and the scope of the right is always to be construed strictly against the corporation, so as carefully to protect the property

18 Wend. (N. Y.) 9; *Beekman v. Saratoga, etc. R. R. Co.*, 3 Paige (N. Y.), 45; *Buffalo & N. Y. C. R. R. Co. v. Brainard*, 9 N. Y. 100; *Aldridge v. Tuscumbia R. R. Co.*, 2 Stew. & Port. (Ala.) 199; *Davis v. Tuscumbia R. R. Co.*, 4 Stew. & Port. (Ala.) 421; *Sadler v. Langham*, 34 Ala. 311; *O'Hara v. Lexington & O. R. R. Co.*, 1 Dana (Ky.), 232; *Concord R. R. Co. v. Greely*, 17 N. H. 47; *San Francisco, etc. R. R. Co. v. Caldwell*, 31 Cal. 367; *Raleigh & G. R. R. Co. v. Davis*, 2 Dev. & Bat. L. (N. C.) 451; *Walther v. Warner*, 25 Mo. 277; *Swan v. Williams*, 2 Mich. 427. The power of eminent domain, together with large discretion as to route, may be given railroad corporations by a general enabling act. *Buffalo & N. Y. C. R. R. Co. v. Brainard*, 9 N. Y. 100; *Weir v. St. Paul, etc. R. R. Co.*, 18 Minn. 155; *National Docks R. R. Co. v. Central R. R. Co.*, 32 N. J. Eq. 755; see *Chicago B. & Q. R. R. Co. v. Chamberlain*, 84 Ill. 333; *Boston Water Power Co. v. Boston & W. R. R. Co.*, 23 Pick. (Mass.) 360.

¹ *Thacher v. Dartmouth Bridge*

Co., 18 Pick. 501; *Phillips v. Dunkirk, etc. R. R. Co.*, 78 Pa. St. 177. See *Allen v. Jones*, 47 Ind. 438; *Rensselaer, etc. R. R. Co. v. Davis*, 43 N. Y. 137. And the right always remains conditioned on the legality of the corporate organization. See § 155.

² *Tracy v. Elizabethtown, etc. R. R. Co.*, 80 Ky. 259; *Chicago and Western Indiana R. R. Co. v. Dunbar*, 100 Ill. 110. Railroad companies cannot thus acquire lands for speculative purposes. *Rensselaer, etc. R. R. Co. v. Davis*, 43 N. Y. 137. See *N. Y. and Canada R. R. Co. v. Gunnison*, 1 Hun, 496. But they may take more than is necessary for their present needs, provided it be no more than reasonably anticipated future business will require. *Lodge v. Phila., Wilm., and Balto. R. R. Co.*, 8 Phila. 345. Compare *Proprietors of Locks and Canals v. Nashua and Lowell R. R. Co.*, 104 Mass. 1.

³ *Matter of New York Central R. R. Co.*, 66 N. Y. 407; *S. C.*, 77 N. Y. 248; *Rensselaer and S. R. Co. v. Davis*, 43 N. Y. 137; *Tracy v. Elizabethtown, etc. R. R. Co.*, 80 Ky. 259.

of individuals from its exercise except for a public use.¹ Nevertheless, statutes conferring the rights of eminent domain are not to be construed so literally as to frustrate the evident intent of the legislature.²

In accordance with these principles it is held that a railroad company may condemn land for proper places to keep cars and locomotives when not in use, and for places to store merchandise between the time of its receipt and dispatch, and after its arrival till called for;³ and generally for proper terminal facilities,⁴ for necessary depots and workshops.⁵

§ 163 *a*. An individual, by devoting property to a public use, acquires no higher rights in that property than he had before. On the contrary, his rights as private owner become more palpably subservient to the rights of the public and to the police power of the state.⁶ Accordingly, as far as concerns the rights of the owners of property devoted to a public use, there is no reason why the legislature should not authorize it to be taken by compulsory process, and as for the rights of the people, the compulsory proceedings are authorized by themselves acting

¹ *Alexandria and F. Ry. Co. v. Alexandria and W. R. R. Co.*, 75 Va. 780; *Doughty v. Somerville*, etc. R. R. Co., 21 N. J. L. 442; *Moorhead v. Little Miami R. R. Co.*, 19 Ohio, 340; *Merritt v. Portchester*, 71 N. Y. 309; *Pueblo, etc. R. R. Co. v. Rudd*, 5 Cal. 270; *Spofford v. Bucksport*, etc. R. R. Co. 66 Me. 26; *East and West R. R. Co. v. East Tennessee*, etc. R. R. Co., 75 Ala. 275; *Alabama Gt. Southern R. R. v. Gilbert*, 71 Ga. 591. See § 122.

² *In re New York and Harlem R. Co. v. Kip*, 46 N. Y. 546. When for some reason a railroad company has no authority to condemn a certain right of way, it may cause another company to be formed of its own shareholders, and to be so organized as to have the requisite power; and after the subsidiary company has condemned the right of way, it may lease the same

to the other company. *Lower v. C. B. and Q. R. Co.*, 59 Iowa, 563. But one railroad company cannot condemn land for another. *Swinney v. Ft. Wayne*, etc. R. R. Co., 59 Ind. 205.

³ *In re New York and H. R. R. Co. v. Kip*, 46 N. Y. 546.

⁴ *New York Central and H. R. R. Co. v. Metropolitan Gas Light Co.*, 63 N. Y. 326; *Matter of New York Central and H. R. R. Co.*, 77 N. Y. 248.

⁵ *Nashville and C. R. R. Co. v. Corvardin*, 11 Humph. (Tenn.) 348; *Gilsy v. Cincinnati U. & S. R. R. Co.*, 4 O. St. 308; *Hamilton v. Annapolis and E. R. R. Co.*, 1 M'd, 560; *Hannibal and St. Jo. R. R. Co. v. Muder*, 49 Mo. 165; *Chicago, B. & Q. R. R. Co. v. Wilson*, 17 Ill. 123; *Southern Pacific R. R. Co. v. Raymond*, 53 Cal. 223.

⁶ See § 475, *post*.

through their plenary political agent, the legislature.¹ Consequently, the legislature can authorize property already devoted to a public use to be taken for another public use by compulsory proceedings;² it can for instance authorize one railroad company to take the property of another, although the same be used by the latter for railroad purposes.³ But the power to take property actually devoted to a public use, is not implied by a simple grant to a railroad company of the power of eminent domain.⁴ Power to take such property arises only by a grant in express terms or by such necessary implication as exists where the powers expressly granted cannot otherwise be exercised; an implication which must have been unavoidable and necessary *ab origine* and not made so by any act of the corporation.⁵ All grants of eminent domain are to be construed

¹ See *Lake Shore and M. S. Ry. Co. v. Chicago and W. I. R. R. Co.*, 97 Ill. 506.

² *Boston Water Power Co. v. Boston and N. R. R. Co.*, 23 Pick. (Mass.) 360; *Chicago R. I. and P. R. R. Co. v. Town of Lake*, 71 Ill. 333; *Alabama and F. R. R. Co. v. Kenney*, 39 Ala. 307; *Lafayette Plank Road Co. v. New Albany, etc. R. R. Co.*, 13 Ind. 90; *New York H. and N. R. R. Co. v. Boston H. and E. R. R. Co.*, 36 Conn. 196; *Northern R. R. v. Concord and C. R. R.*, 27 N. H. 183; *White River T. Co. v. Vermont Central R. R. Co.*, 21 Vt. 590; *Thorpe v. Rutland and B. R. R. Co.*, 27 Vt. 140; *Wood v. Macon, etc. R. R. Co.*, 68 Ga. 539; *Matter of Prospect Park and C. I. R. R. Co.*, 67 N. Y. 371. See *Iron R. R. Co. v. Ironton*, 19 O. St. 299; *Commonwealth v. Essex Co.*, 13 Gray (Mass.), 239, 247. Compare *Lake Shore and M. S. Ry. Co. v. Chicago and N. I. R. R. Co.*, 97 Ill. 506.

³ *Eastern R. R. Co. v. Boston and M. R. R. Co.*, 111 Mass. 125; *Lake Shore and M. S. Ry. Co. v. Chicago*

and *W. I. R. R. Co.*, 97 Ill. 506; *Oregon Ry. Co. v. Portland*, 9 Oregon, 231; *Sixth Avenue R. R. Co. v. Kerr*, 72 N. S. 330; *Kinsman Street R. R. Co. v. Broadway R. R. Co.*, 36 O. St. 239; and cases in preceding note.

⁴ *Contra, Costa Coal Mines R. R. Co. v. Moss*, 23 Cal. 323; *State v. Montclair Ry. Co.*, 35 N. J. L. 328.

⁵ *Pennsylvania R. R. Co.'s Appeal*, 93 Pa. St. 150; *Matter of Boston and Albany R. R. Co.*, 53 N. Y. 574; *Matter of City of Buffalo*, 68 N. Y. 167; *Prospect Park and C. I. R. R. Co. v. Williamson*, 91 N. Y. 552; *Oregon Ry. Co. v. Portland*, 9 Oregon, 231; *Inhabitants of Springfield v. Connecticut River R. R. Co.*, 4 Cush. (Mass.) 63; *Housatonic R. R. Co. v. Lee, etc. R. R. Co.*, 118 Mass. 391; *Boston and M. R. R. Co. v. Lowell, etc. R. R. Co.*, 124 Mass. 368. But these strict rules do not apply where the property sought to be taken though owned by a railroad company is not used for railroad purposes. *Boston Water Power Co. v. Boston and N. R. R. Co.*, 23 Pick. (Mass.) 360; *North*

strictly against the grantee, especially when it is attempted to construe the grant so as to interfere with the exercise of a previous grant of the same kind.¹

It is competent for a state to compel a railroad company to allow another railroad company to connect with it,² or to cross its track.³ And if a company is chartered to build a railroad between two termini in a line that will cross the tracks of prior railroads, the right to cross those tracks will arise by implication.⁴ But no more than the property of other owners can the property of a railroad company be taken or injured without just compensation; nor without just compensation can a railroad company be forced to allow its tracks to be used or even crossed by another railroad company. And it is not competent for the legislature to fix the compensation.⁵

§ 164. As to whether and in what respect a single exercise of the power of eminent domain by a railroad corporation exhausts its right there is a conflict of authorities. Undoubtedly a railroad company chartered with power to build

Carolina, etc. *R. R. Co. v. Carolina Central Ry. Co.*, 83 N. C. 489; *Peoria P. and I. R. R. Co. v. Peoria and S. R. R. Co.*, 66 Ill. 174; *Baltimore and O. R. R. Co. v. Pittsburgh W. and K. R. R. Co.*, 17 W. Va. 812.

¹ *Pennsylvania R. R. Co.'s Appeal*, 93 Pa. St. 150. See §§ 470-473.

² See *Louisville & N. R. R. Co. v. State*, 9 Bax. (Tenn.) 522. Compare *North Branch Passenger R'y Co. v. City Passenger R'y Co.*, 38 Pa. St. 361; *Branson p. City of Philadelphia*, 47 Pa. St. 329.

³ *Lake Shore & M. S. R'y Co. v. Cincinnati, S. & C. R'y Co.*, 30 O. St. 604; *Pittsburgh & C. R. R. Co. v. Southwest Pennsylvania R. R. Co.*, 77 Pa. St. 173; *Baltimore, etc. T. Co. v. Union R'y Co.*, 35 Md. 224; *Western Pennsylvania R. R. Co.'s Appeal*, 99 Pa. St. 155.

⁴ *Morris & E. R. R. Co. v. Central R. R. Co.*, 31 N. J. L. 205; *State v.*

Eastern & A. R. R. Co., 36 N. J. L. 181. Contra, *Costa Coal Mines v. Moss*, 23 Cal. 323.

⁵ *Pennsylvania R. R. Co. v. Baltimore & O. R. R. Co.*, 60 Md. 263; *Southwestern R. R. Co. v. Southern, etc. Tel. Co.*, 46 Ga. 43. Compare with last case *New Orleans, etc. R. R. Co. v. Southern, etc. Tel. Co.*, 53 Ala. 211; *Baltimore, etc. T. Co. v. Union R'y Co.*, 35 Md. 224; *Northern Central R'y Co. v. Mayor, etc. of Baltimore*, 46 Md. 425; *Metropolitan R. R. Co. v. Highland St. R'y Co.*, 118 Mass. 290. It is held in Massachusetts that a railroad company is entitled to compensation for a public highway laid out across its track. *Old Colony, etc. R. R. Co. v. County of Plymouth*, 14 Gray, 155. Contra, *Albany Northern R. R. Co. v. Brownell*, 24 N. Y. 345; *Boston & A. R. R. Co. v. Greenbush*, 52 N. Y. 510.

its road on a certain route, has no authority to lay its road elsewhere; nor has a company that has actually selected its route and built its road, authority to change its route subsequently.¹ It has also been said that a railroad corporation by laying out to its satisfaction its road with the appendages, entirely exhausts all the powers conferred on it to take land.² But, it is submitted, it is the right of the railroad company to re-locate its road that is wanting,³ and not its right of eminent domain that is exhausted.⁴ And there is ample authority sustaining the rule, that notwithstanding a railroad corporation has already exercised its right of eminent domain, it may make whatever further appropriations are necessary for its road or stations, provided the making of any given appropriation is not in itself an act unauthorized by the constitution of the corporation.⁵

§ 165. In the exercise of its right of eminent domain a corporation may take the fee or whatever interest in the land may be necessary to accomplish its purpose.⁶ If it takes the fee it

¹ *Mason v. Brooklyn City, etc. R. Co.*, 35 Barb. 373; *Brooklyn Central R. R. Co. v. Brooklyn City R. Co.*, 32 Barb. 358; *Hudson and Del. Canal Co. v. New York and Erie R. Co.*, 9 Paige, 323; *Kenton County Court v. Bank Lick Turnpike Co.*, 10 Bush (Ky.), 529; *Brigham v. Agricultural Branch R. R. Co.*, 1 Allen, 316. See *Moorhead v. Little Miami R. R. Co.*, 17 Ohio, 340. But see *Mississippi and Tenn. R. R. Co. v. Devaney*, 42 Miss. 555; *Ex parte South Carolina R. R. Co.*, 2 Rich. L. (S. C.) 434.

² *Morris and Essex R. R. Co. v. Central R. R. Co.*, 31 N. J. L. 205, 210.

³ See § 162a.

⁴ "Strictly speaking there is no such thing as an extinction of the right of eminent domain." *New York, Housatonic, etc. R. R. Co. v. Boston,*

Hartford and Erie R. R. Co., 36 Conn. 196, 198.

⁵ *Dietrichs v. Lincoln, etc. R. Co.*, 13 Neb. 361; *Central Branch U. P. R. R. Co. v. Atchison T. and S. F. R. R. Co.*, 26 Kans. 669; *Chicago, B. and Q. R. R. Co. v. Wilson*, 17 Ill. 123; *Fisher v. Chicago and Springfield R. R. Co.*, 104 Ill. 323; *Miss. and Tenn. R. R. Co. v. Devaney*, 42 Miss. 555; *Virginia and Truckee R. Co. v. Lovejoy*, 8 Nev. 100; *Prather v. Jeffersonville, etc. R. R. Co.*, 52 Ind. 16; *Toledo and Wabash R'y Co. v. Daniels*, 16 Ohio St. 390; *Hamilton v. Annapolis, etc. R. R. Co.*, 1 Md. 553; *Ex parte South Carolina R. R. Co.*, 2 Rich. L. (S. C.) 434. See *Western Pennsylvania R. Co.'s Appeal*, 99 Pa. St. 155.

⁶ *Sixth Ave. R. R. Co. v. Kerr*, 72 N. Y. 330. See *Challiss v. Atchinson, etc. R. R. Co.*, 16 Kan. 117.

acquires an exclusive right to the property.¹ And whatever interest it may take, it may have rights, privileges, or immunities in regard thereto not ordinarily possessed by individuals. For instance, real estate thus acquired by a railroad company, which is necessary for uses in which the public is interested, cannot be sold on execution apart from the franchises of the corporation.²

Rights of the corporation as to land acquired by eminent domain.

§ 166. The right of eminent domain is not transferable.³ After the time has expired within which a railroad corporation is required to complete its road, it cannot exercise the right of eminent domain;⁴ nor can it do so after the expiration of the time to which the exercise of the right is expressly limited.⁵ In condemning land the statute authorizing the proceedings must be strictly complied with, and this compliance must appear by the record of the proceedings.⁶

Eminent domain not transferable.

¹ See *Isabel v. Hannibal and St. Jo. R. R. Co.*, 60 Mo. 475; *Cauley v. Pittsburgh, etc. R. R. Co.*, 95 Pa. St. 398; *Jersey City and Bergen R. R. Co. v. Jersey City and Hoboken R. R. Co.*, 20 N. J. Eq. 61; reversed in part, 21 N. J. Eq. 550; *Camden Horse R. R. Co. v. Citizens' Coach Co.*, 31 N. J. Eq. 525.

² *Gooch v. McGee*, 83 N. C. 59.

³ *Mahoney v. Spring Valley Water Co.*, 52 Cal. 159. A lease for one hundred years of a railroad does not vest in the lessee the right of eminent domain of the lessor. *Mayor, etc. of Worcester v. Norwich, etc. R. R. Co.*, 109 Mass. 103. But the person whose property has been taken cannot question the right of the railroad company to transfer that. *Crolley v. Minneapolis & St. L. Ry. Co.*, 30 Minn. 541. And the fact that a railroad company has leased its road for the full period of its corporate life, does not affect its right to take land by eminent domain: and that the lessee is a for-

eign corporation is immaterial. *Matter of Petition of New York, Lackawanna, etc. R. R. Co.*, 99 N. Y. 12.

⁴ *Peavy v. Calais R. R. Co.*, 30 Me. 498; *New York, Housatonic, etc. R. R. Co. v. Boston, Hartford, and Erie R. R. Co.*, 36 Conn. 196; *Atlantic & P. R. R. Co. v. St. Louis*, 66 Mo. 228; see § 155.

⁵ *Morris and Essex R. R. Co. v. Central R. R. Co.*, 31 N. J. L. 205. See *ante*, § 155.

⁶ *Nichols v. Bridgeport*, 23 Conn. 189; *Pueblo, etc. R. R. Co. v. Rudd*, 5 Col. 270; *Mobly v. Breed*, 48 Ga. 44; *Ellis v. Pacific R. R. Co.*, 51 Mo. 200; *Cunningham v. Pacific R. R. Co.*, 61 Mo. 33; *Kansas City, St. Jo., etc. R. R. Co. v. Campbell*, 62 Mo. 585; *Hyslop v. Finch*, 99 Ill. 171; *Southern Pacific R. R. Co. v. Wilson*, 49 Cal. 396; *Mitchell v. Illinois & St. L. R. R. Co.*, 68 Ill. 286; *Oregonian Ry. Co. v. Hill*, 9 Oregon, 377.

PART II.

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§ 167. So long as a corporation neglects no duty which it owes the public, acts within the scope of its competently conferred powers, and in so acting uses due care not to injure others, it will not be liable for the inconvenience or even damage which its actions may cause, provided they do not constitute a taking of private property.¹ This proposition requires elucidation.²

When a corporation is not liable for loss occurring by reason of its acts.

¹ See *Gilbert v. Savannah, etc. R. R.*, 69 Ga. 396. "Whenever the ex-

ercise of a right, conferred by law for the benefit of the public, is attended

² It is well to remember that grants of special franchises and privileges are always to be construed strictly against

the grantee, and in favor of the public. *Turnpike Co. v. Illinois*, 96 U. S. 63. See *ante*, § 122.

§ 168. The manner in which a corporation may be compelled to discharge the duties it owes the public is discussed in Chapter VIII.¹ If a corporation is chartered to subserve a public convenience, and receives special privileges and powers to be used by it in fulfilling the purposes of its incorporation, it would seem but logical that those powers and privileges should cease to constitute a protection to the corporation as soon as the corporation itself ceases to fulfil its purposes. Such would undoubtedly be the law, were it not for the rule that the franchises of a corporation cannot be questioned collaterally.² Consequently, franchises ordinarily subsist as valid and afford protection until they are declared forfeited in a proceeding instituted for that purpose.³

with temporary inconvenience to private parties, in common with the public in general, they are not entitled to any damages therefor." *Hamilton v. Vicksburg, etc. R. R. Co.*, 119 U. S. 280, 285. Opinion of the court, per Field, J. Compare *Cogswell v. New York N. H. & H. R. R. Co.*, 103 N. Y. 10. Thus a telegraph company, which has the right to place its line in the streets of a city, is not liable for a personal injury resulting from the breaking of a telegraph pole, save upon proof of culpable negligence on its part. The company is bound to use reasonable care in the construction and maintenance of its line, but is not bound so to erect and manage its line as to guard against storms, which, on account of their extraordinary severity, could not reasonably have been anticipated. The company is no insurer of travellers against injuries from its poles lawfully placed in the streets. *Ward v. Atlantic and Pac. Tel. Co.*, 71 N. Y. 81. See *Borchardt v. Wausau Boom Co.*, 54 Wis. 107; *Sumner v. Richardson Lake Dam Co.*, 71 Me. 106; *City of Georgetown v. Alexandria Canal Co.*, 12 Pet. 91. Compare

Smith v. Corporation of Washington, 20 How. 135.

By making a negligent or improper use of its franchises, a corporation may become a public nuisance. Thus it is an indictable public nuisance for a railroad company to run its trains across a turnpike at the rate of fifteen or twenty miles an hour, without giving sufficient warnings. *Lou., Cin., and Lex. R. R. Co. v. Commonwealth*, 80 Ky. 143. Likewise it constitutes a public nuisance for a railroad company to raise its tracks so high at a public crossing that it is dangerous to drive over them. *Paducah, etc. R. R. Co. v. Commonwealth*, *ib.* 147. A corporation may be indicted for a nuisance. *State v. Western, etc. R. R. Co.*, 95 N. C. 602.

¹ §§ 454 *et seq.*

² See *ante*, §§ 145-157. Compare *Newell v. Minneapolis, etc. Ry. Co.*, 35 Minn. 112.

³ *Logan v. Vernon, etc. R. R. Co.*, 90 Ind. 552; see *Atlantic and P. R. R. Co. v. St. Louis*, 66 Mo. 228; *New York Cable Co. v. Mayor, etc. of New York*, 104 N. Y. 1, 43.

§ 169. On the other hand, the fact that a corporation is violating a duty owed by it primarily to the public, for a violation of which the state might forfeit its franchises; or the fact that a corporation is exceeding its corporate powers, and is thereby rendering itself liable to a forfeiture of its franchises, does not prevent an individual who has suffered special damage through its wrongful acts or omissions, from maintaining an action against it on his own behalf.¹ Indeed, a corporation will be liable in damages to any person who suffers injury peculiar to himself from the negligent or improper use of its franchises.² For instance, the right of a railroad company to lay its tracks in a street or highway imposes on it the obligation to lay them properly and keep them in repair, and if an injury by reason of its neglect in either of these respects is occasioned to any one, the company will be liable.³

But for their improper use the corporation liable to injured individuals.

§ 170. Furthermore, a corporation that has received special franchises ordinarily continues liable for injuries occurring through the negligent exercise of powers originally conferred on it, although it may have delegated or assigned a portion or the whole of its powers to another corporation or to an individual. Thus, a railroad corporation that has granted the use of its road to another company will be liable for accidents to passengers carried by itself, caused by the negligent management of the trains of the other company.⁴ And a railroad company is not ex-

Continuation of liability after a delegation of franchises.

¹ *Riddle v. Proprietors of Locks and Canals*, 7 Mass. 169. See *Mayor of Lynn v. Turner*, Cowper, 86; *Mersey Docks v. Gibbs*, 11 H. L. C. 686; S. C., L. R. 1 H. L. 93; *Winch v. Conservators of the Thames*, L. R. 7 C. P. 458; *Conrad v. Trustees of Ithaca*, 16 N. Y. 158.

² A railroad company is liable in damages for establishing its engine houses so near an incorporated church as to constitute a nuisance by reason of the noise and smoke. *Baltimore and P. R. Co. v. Fifth Baptist Church*, 108 U. S. 317.

³ *Worcester v. Forty-second Street R. R. Co.*, 50 N. Y. 203. See also *Baltimore, etc. Turnpike Co. v. Cas-sell*, 66 Md. 419. No notice to the company of a patent defect is necessary. The presumption of negligence is complete when it appears that the defect existed and caused an injury. *Ib.* As to *prima facie* evidence of negligence, compare *Stokes v. Saltonstall*, 13 Pet. 181; *Railroad Co. v. Pollard*, 22 Wall. 341.

⁴ *Railroad Company v. Baron*, 5 Wall. 90; see *Abbott v. Johnstown Horse R. R. Co.*, 80 N. Y. 27; *Feital*

empted from liability for the loss of goods delivered to it to be carried over a part of its road by the fact that it had previously leased that part to another corporation; for, as the court said, to have allowed this exemption "would be to authorize them by their own act to divest themselves of the duties and liabilities imposed upon them by law, and the performance of which was the consideration upon which their charter was granted, and which thus entered into their contract with the commonwealth."¹

The weight of authority sustains the proposition that by leasing its road a railroad company does not escape liability for injury to goods transported by its lessee,² nor for injuries to the lessee's passengers occasioned by the lessee's negligence.³ On the other hand, when one railroad company competently takes a lease of the road of another, its liabilities springing from the operation of the leased road are determined, not by its own charter, but by the charter of the lessor company.⁴

v. Middlesex R. R. Co., 109 Mass. 398; *Lakin v. Railroad Co.*, 13 Oreg. 436.

¹ *Langley v. Boston and Maine R. Co.*, 10 Gray, 103; see *McCluer v. Manchester and Lawrence R. R.*, 13 Gray, 124; *Quested v. Newburyport Horse Railroad*, 127 Mass. 204; *Bower v. B. & S. W. R. Co.*, 42 Iowa, 546. See *State v. Railroad Commissioners*, 41 N. J. L. 235. In the absence of statutory provisions, a railroad company after leasing its road remains liable for injuries caused by defects in its tracks at a highway crossing. *Freeman v. Minneapolis and St. Louis R'y Co.*, 28 Minn. 443; but see *Ditchett v. Spuyten Duyvil, etc. R. R. Co.*, 67 N. Y. 425. So, where the railroad is operated by persons who are trustees for the corporation as well as for its bondholders, the corporation may be sued. *Grand Tower M'f'g, etc. Co. v. Ullman*, 89 Ill. 244. Otherwise if the road is in the hands of a receiver.

Turner v. Hannibal and St. Jo. R. R. Co., 74 Mo. 602; *Heath v. Missouri, etc. R'y Co.*, 83 Mo. 617; *Metz v. Buffalo, etc. R. R. Co.*, 58 N. Y. 61; *Hicks v. International, etc. R. R. Co.*, 62 Tex. 38. But see *Ohio & M. R'y Co. v. Russell*, 115 Ill. 52. As to the power of a railroad corporation to lease or otherwise transfer its franchises, see §§ 125, 132, 304, 305.

² *Ohio & M. R. R. Co. v. Dunbar*, 20 Ill. 623; *Peoria & R. I. R. R. Co. v. Lane*, 83 Ill. 448.

³ *Singleton v. Southwestern R. R.*, 70 Ga. 464. To the contrary, *Missouri Pac. Ry. Co. v. Watts*, 63 Tex. 549, holds, that after an authorized lease of its road, the lessor is not liable for the torts of the lessee. See § 305 and note.

⁴ *McMillan v. Michigan Southern, etc. R. R. Co.*, 16 Mich. 79. See *Stone v. Illinois Central R. R. Co.*, 116 U. S. 347. A railroad company cannot dispute its liability for goods

As a corporation cannot escape responsibility for the performance of its duties by leasing its property or franchises,¹ so it cannot, by delegating matters to a contractor, escape from the fulfilment of its undertakings or from responsibility for the observance of due care in the exercise of its franchises.² Accordingly, where a corporation contracted to lay water-pipes in a city, agreeing to "protect all persons against damages by reason of excavations made by them in laying pipes, and to be responsible for all damages which might occur by reason of the neglect of their employés on the premises," it was held, although the corporation had let the work out to a contractor, that it was liable for injuries incurred by a person passing over the street caused by the negligence of the contractor's servants.³ So a railroad company may be responsible to adjacent land-owners for the trespasses of its contractors in constructing its road,⁴ and will ordinarily be liable for the acts of its contractors, as if they were its servants, where the contractors in their work are under the direction of the company,⁵ or where the company itself is the real cause of the injuries occasioned by the acts or omissions of the contractor.⁶

§ 171. If the acts of a corporation within the scope of its powers amount to a taking of private property, then that the corporation is acting within its powers has the effect of preventing its action from amounting to a public or private nuisance,⁷ but

Corporation always liable when its acts amount to a taking of private property.

carried by it over a leased road on the ground that the lease is void. *McCluer v. Manchester, etc. R. R.*, 13 Gray (Mass.), 124. See § 416.

¹ See *Chicago & N. W. Ry. Co. v. Crane*, 113 U. S. 424.

² *Lakin v. Railroad Co.*, 13 *Oreg.* 436.

³ *Water Co. v. Ware*, 16 Wall. 566.

⁴ *Rockford, etc. R. R. Co. v. Wells*, 66 Ill. 321; *Chicago & R. I. R. R. Co. v. Whipple*, 22 Ill. 105. But see *Hitte v. Republican Valley R. R. Co.*, 19 Neb. 620, which holds that a railroad company is not liable for the acts of an independent contractor in building its road.

⁵ *Railroad Co. v. Hanning*, 15 Wall. 649.

⁶ See *Philadelphia, etc. R. R. Co. v. Phila., etc. Towboat Co.*, 23 How. 209.

⁷ See *City of Georgetown v. Alexandria Canal Co.*, 12 Pet. 91; *Grand Rapids, etc. R. R. Co. v. Heisel*, 38 Mich. 62. Compare the *Clinton Bridge*, 10 Wall. 454; *State of Pennsylvania v. Wheeling, etc. Bridge Co.*, 18 How. 421; *Danville, etc. R. R. Co. v. Commonwealth*, 73 Pa. St. 29; *Ingram v. C. D. & M. R. R. Co.*, 38 Iowa, 669.

does not exempt it from the duty to compensate the owner for his property.¹

In the first place regarding the force of the word *private*. If a railroad company, or other corporation with public duties, is authorized to use or take property belonging to the public, that is property which is vested in some political body or department, the question whether compensation is to be made depends on the terms of the authority; it is merely a question of legislative intention.² It is always competent for the legislature to change property from one public use to another without compensating any public (*e. g.*, municipal) body.³ It has even been held that authority from the state to a corporation or an individual to build roads or bridges upon public property, implies the right to proceed without compensation, since the function to be performed is that of the sovereign, though delegated to a citizen.⁴ If, however, private rights exist in property held by the public, compensation for them must be provided on a change of its use. Thus, when land is conveyed to a city in trust for a public park, the legislature cannot authorize a railroad company to build its road across it without providing compensation for the right of the original proprietors that the land should continue to be used according to the trust on which they conveyed it.⁵

§ 172. But what is property? and what constitutes a taking of it? "Property" means a thing owned, and, also, something entirely different, *i. e.*, the rights of the owner respecting the thing owned, or the rights of a person respecting a thing in any way subject to his

Meanings
of the term
"property,"

¹ "This power to take private property reaches back of all constitutional provisions; and it seems to have been considered a settled principle of universal law, that the right to compensation is an incident to the exercise of that power; that the one is so inseparably connected with the other, that they may be said to exist, not as separate and distinct principles, but as parts of one and the same principle." *Sinnick-*

son v. Johnson, 17 N. J. Law (2 Har-
rison), 129, 145. "See § 473.

² *Commonwealth v. Boston & M.
Railroad*, 3 Cush. (Mass.) 25.

³ *People v. Kerr*, 27 N. Y. 188.

⁴ *Pennsylvania R. R. Co. v. New
York & L. B. R. R. Co.*, 23 N. J. Eq.
157. But see *County of Blue Earth
v. St. Paul, etc. R. R. Co.*, 28 Minn.
503.

⁵ *City of Jacksonville v. Jackson-
ville Ry. Co.*, 67 Ill. 540.

control. In this latter sense the term embraces rights in action as well as rights in possession.¹

§ 173. To constitute a taking of property, it is not necessary that any material thing be actually taken; it is enough if any right of the owner respecting the thing owned be impaired, so that he cannot apply the thing to all the uses of which it was formerly capable.² The legislature cannot authorize either a direct or a consequential taking or injury to property without compensation; and if a corporation voluntarily, for its own benefit, so constructs a work as necessarily to injure the property (*i. e.*, the thing owned) of an individual, or deprive him of any right he may possess regarding a thing which he owns or has rights in, it will be bound to compensate him for his damages, even though the work be properly and lawfully constructed.³

Thus it is the better opinion that a railroad company is liable for throwing back surface water by the erection of an embankment on its land;⁴ and also is liable if it collects surface water in one channel, and in this manner discharges it upon plaintiff's land, although the total volume of the flow is not thereby increased.⁵ Likewise railroad companies are liable for damages

¹ *United States v. Reynes*, 9 How. 127, 151. A common law right of action (not based on a penalty) is property. *Dunlap v. Toledo*, A. A., etc. R'y Co., 50 Mich. 470.

² *Pumpelly v. Green Bay Co.*, 13 Wall. 166; which held the backing of water so as to overflow the lands of individuals to be such a taking. *Acc. Alton Horse R'y Co. v. Deitz*, 50 Ill. 210; *Little Rock, etc. R'y Co. v. Chapman*, 39 Ark. 463; *Grand Rapids Booming Co. v. Jarvis*, 30 Mich. 308. Compare *O'Connor v. Fon du Lac, etc. R'y Co.*, 52 Wis. 526.

³ *Evansville, etc. R. R. Co. v. Dick*, 9 Ind. 433; *Terre Haute Gas Co. v. Teel*, 20 Ind. 131; *Baltimore and Potomac R. R. Co. v. Reany*, 42 Md. 117; *Ten Eyck v. Delaware and Raritan Canal Co.*, 18 N. J. L. 200;

Story v. New York Elevated R. R. Co., 90 N. Y. 122.

⁴ *Shane v. Kansas City, St. Jo. & C. B. R. R. Co.*, 71 Mo. 237; *Carriger v. East Tennessee V. & G. R. R. Co.*, 7 Lea (Tenn.), 388; *Indianapolis B. & W. R. R. Co. v. Smith*, 52 Ind. 428; *Toledo W. & W. Ry. Co. v. Morrison*, 71 Ill. 616; *Weaver v. Mississippi, etc. Boom-Co.*, 28 Minn. 534. See *Rau v. Minnesota Valley R. R. Co.*, 13 Minn. 442. *Contra, Morrison v. Buckport & B. R. R. Co.*, 67 Me. 353; *Hamlin v. Chicago & N. W. Ry. Co.*, 61 Wis. 515. See *Benson v. Chicago & Q. R. R. Co.*, 78 Mo. 504; and compare *Moyer v. N. Y. C. & H. R. R. R. Co.*, 88 N. Y. 351.

⁵ *McCormick v. Kansas City, St. Jo. & C. B. R. R. Co.*, 70 Mo. 360; *S. C.*, 57 Mo. 433; *G. C. & S. F. Ry.*

caused by obstructing drains and closing ditches, whereby the flow of water is impeded, and crops are destroyed.¹

§ 174. If the person claiming compensation is not the full owner of the property appropriated, it is sufficient to entitle him to compensation, that he have some right or privilege therein secured by grant, which right or privilege is injured or abridged by the appropriation.² But that he should have some legal rights in the property is necessary;³ and it has accordingly been held that unavoidably obstructing the navigation of a river during the construction of a railroad bridge is *damnum absque injuria*;⁴ and riparian owners on a navigable river cannot recover damages for a diversion of its waters by a corporation acting under authority from the legislature.⁵ On the other hand riparian owners on navigable rivers or lakes have the right of unobstructed access to the navigable channel, and this right cannot be taken from them without compensation.⁶

Co. v. Donahoo, 59 Tex. 128. Compare Eaton v. Boston, C. & M. R. R., 51 N. H. 504.

¹ Bourdier v. Morgan L. & T. R. R. Co., 35 La. Ann. 947; Waterman v. Connecticut & P. Rivers R. R. Co., 30 Vt. 610; Mississippi Central R. R. Co. v. Caruth, 51 Miss. 77.

² Story v. New York Elevated R. R. Co., 90 N. Y. 122, 168.

When a water company is chartered with the right to take and use the waters of a stream on making compensation, the owner of a mill-race who has purchased the right to use the water, of which the flow is diminished by the action of the water company, has an incorporeal right for which he is entitled to compensation. Lycoming Gas and Water Co. v. Moyer, 99 Pa. St. 615.

³ See St. Louis R. R. Co. v. Northwestern St. Louis Ry. Co., 69 Mo. 65.

⁴ Hamilton v. Vicksburg, etc. R. R. Co., 119 U. S. 280.

⁵ Rundle v. Delaware & R. Canal Co., 14 How. 80; Black River Improvement Co. v. La Crosse Booming, etc. Co., 54 Wis. 659; Rogers v. Kennebec & P. R. R. Co., 35 Me. 319.

See Fitchburg R. R. Co. v. Boston & M. Railroad, 3 Cush. (Mass.) 58; and compare Arnold v. Hudson River R. R. Co., 55 N. Y. 661; Kinealy v. St. Louis, etc. Ry. Co., 69 Mo. 658; *semble contra*, Tinsman v. Belvidere Delaware R. R. Co., 26 N. J. L. 148.

⁶ Yates v. Milwaukee, 10 Wall. 497; Delaplaine v. Chicago & N. W. Ry. Co., 42 Wis. 214; Chapman v. Oshkosh & M. R. R. Co., 33 Wis. 629; Union Depot, etc. Co. v. Brunswick, 31 Minn. 297; see Drury v. Midland R. R. Co., 127 Mass. 571; Alexandria & F. Ry. Co. v. Faunce, 31 Grat. (Va.) 761; Brisbane v. St. Paul & S. E. R. R. Co., 23 Minn. 114; and compare Thayer v. New Bedford R. R. Co., 125 Mass. 253; and Rail-

§ 175. One of the most important classes of cases where persons have claimed compensation for the taking of property over which they have not unqualified ownership, or in which they have only an easement, are cases where railroad companies have been authorized to lay tracks in public streets or highways. The building of a horse railroad is held not to be an appropriation of the street to a new use, for which adjoining lot owners are entitled to compensation, even though they own the fee of the street.¹ This seems correct, and on the principles stated by Chief Justice Shaw: "Where under the authority of the legislature, in virtue of the sovereign power of eminent domain, private property has been taken for a public use, and a full compensation for a perpetual easement in land has been paid to the owner therefor, and afterwards the land is appropriated to a public use of a like kind, as where a turnpike has by law been converted into a common highway, no new claim for compensation can be sustained by the owner of the land over which it passes."²

Railroad
tracks in
streets.

way Co. v. Renwick, 102 U. S. 180. But, *semble contra*, Stevens v. Paterson & N. R. R. Co., 34 N. J. L. 532; Boston & W. R. R. Co. v. Old Colony R. R. Co., 12 Cush. (Mass.) 605.

¹ Attorney-General v. Metropolitan R. R. Co., 125 Mass. 515; Hobart v. Milwaukee City R. R. Co., 27 Wis. 194; Hodges v. Baltimore Passenger Ry. Co., 58 Md. 603; Mahady v. Bushwick R. R. Co., 91 N. Y. 148; Railway Co. v. Lawrence, 38 O. St. 41; Faust v. Passenger Ry. Co., 3 Phila. (Pa.) 164; Cincinnati and S. G. Ave. Ry. Co. v. Cummins ville, 14 O. St. 523; Hinchman v. Paterson Horse R. R. Co., 17 N. J. Eq. 75; see People v. Kerr, 27 N. Y. 188; Killinger v. Forty-Second St. R. R. Co., 50 N. Y. 206. Compare Carli v. Stillwater Street Ry. Co., 28 Minn. 373; Carson v. Central R. R. Co., 35 Cal. 325; Roberts v. Easton, 19 O. St. 78.

² Chase v. Sutton M'f'g Co., 4 Cush. (Mass.) 152, 157. But it accords with these principles, and has been held, that the owner is entitled to compensation when the horse railroad company changes the grade of the street and obstructs its use. Cincinnati and S. G. Ave. Ry. Co. v. Cummins ville, 14 O. St. 523. The owner of the fee of a highway is entitled to compensation for laying gas pipes under a highway, and parallel with it. Sterling's Appeal, 111 Pa. St. 35.

The use of a highway by a telegraph company, as authorized by law and subject to the supervision of the local municipal authorities, is a public use similar to that for which the highway was originally taken, or to which it was originally devoted, and the owner of the fee is entitled to no further compensation. Pierce v. Drew, 136 Mass. 75; two judges dissenting. Contra, Board of Trade Telegraph

§ 175 a. Obviously an ordinary steam railway is very different from street cars. The track cannot be used at all for wagons, and driving by the side of it is dangerous. Unquestionably such a railway obstructs the use of a street as a street. Many of the cases adjudicating the right of abutting owners to compensation for the use of a street by a steam railroad have turned on the ownership of the fee of the street. It has been held that an adjoining owner who owns the fee of the street has a right of action for the consequential injury to his abutting freehold, resulting for instance from the decrease of its selling or rental value; but that to entitle the adjoining owner who does not own the fee of the street to compensation, some misconduct on the part of the railroad company must be shown, such for instance as leaving cars for an unreasonable time in front of his premises or running locomotives at a dangerous rate of speed.¹ Many cases support the proposition that an abutting owner owning the fee of the street is entitled to compensation for a steam railroad built thereon,² though there are opposing decisions.³ On the other hand, cases hold that when

Co. v. Barnett, 107 Ill. 507, in which case it was held that trespass would lie at suit of the owner of the fee. It is to be noticed that the Illinois Constitution provides that "private property shall not be taken or damaged without just compensation."

¹ Grand Rapids and I. R. R. Co. v. Heisel, 38 Mich. 62; S. C., 47 Mich. 393.

² Williams v. New York Central R. Co., 16 N. Y. 97; Wager v. Troy Union R. R. Co., 25 N. Y. 526; Presbyterian Society v. Auburn and R. R. R. Co., 3 Hill (N. Y.) 567; Schurneier v. St. Paul and P. R. R. Co., 10 Minn. 82; Harrington v. St. Paul and S. C. R. R. Co., 17 Minn. 215; Hastings and G. I. R. R. Co. v. Ingalls, 15 Neb. 123; Kucheman v. C. C. and D. Ry. Co., 46 Iowa, 366; Terre Haute and S. E. R. R. Co. v. Rodel, 89 Ind. 128; Imlay v. Union Branch R. R.

Co., 26 Conn. 249; Southern Pacific R. R. Co. v. Reed, 41 Cal. 256; Mumma v. Harrisburg, etc. R. R. Co., 1 Pearson (Pa.) 24; Mining v. New York C. and St. L. R. R. Co., 11 Weekly Notes Cases (Pa.), 297; Phillips v. Dunkirk, W. and P. R. R. Co., 78 Pa. St. 177; Indianapolis B. and W. R. R. Co. v. Hartley, 67 Ill. 439; Chicago and W. I. R. R. Co. v. Ayres, 106 Ill. 511; Cox v. Louisville N. A. and C. R. R. Co., 48 Ind. 178; Sherman v. Milwaukee L. S. and W. R. R. Co., 40 Wis. 645; see Starr v. Camden and A. R. R. Co., 24 N. J. L. 572.

³ See Brainard v. Missisquoi R. R. Co., 48 Vt. 107; Morris and E. R. R. Co. v. Newark, 10 N. J. Eq. 352; and some of the older Penn. cases, e. g., Snyder v. Pennsylvania R. R. Co., 55 Pa. St. 340.

a railway is built properly on a street, the abutting owner who does not own the fee of the street is not entitled to compensation for the injury resulting to his property.¹

After all, this question of the ownership of the fee of the street is barren. Even if the abutting owner owns the fee of the street, the use of the street by the public absorbs and constitutes the whole value of it, and the possibility of reverter in case of the cessation of such use is remote.² The substantial rights of the abutting owner are no greater when he owns the fee of the street than when he does not. In whomsoever may be vested the fee of the street, the abutting owner is damaged, if at all, with respect to his abutting premises. Accordingly, a number of recent cases ignore the question of ownership of the fee of the street, and award the abutting owner whatever special damages he has suffered by reason of the building of the railroad in front of his premises.³

¹ *Grand Rapids and I. R. R. Co. v. Heisel*, 38 Mich. 62; *S. C.*, 47 Mich. 393; *Davis v. C. and N. W. R. Co.*, 46 Iowa, 389; *Houston and T. C. R. R. Co. v. Odwin*, 53 Tex. 343; *Stetson v. Chicago and E. R. R. Co.*, 75 Ill. 74; *Moses v. Pittsburgh, Ft. W. and C. R. R. Co.*, 21 Ill. 516; *Milburn v. City of Cedar Rapids*, 12 Iowa, 246; *Atchison and N. R. R. Co. v. Garside*, 10 Kan. 552; *Nottingham v. Baltimore and P. R. R. Co.*, 3 MacArthur (Dist. of Col.) 517; *Koelmel v. New Orleans M. and C. R. R. Co.*, 27 La. Ann. 442. But see *Central Branch W. P. R. R. Co. v. Andrews*, 30 Kan. 590; but the abutting owner, though not owning the fee of the street, is entitled to damages if the railroad company is unlawfully or improperly constructed or operated. *Stange v. Hill, etc. Street Ry. Co.*, 54 Iowa, 669; *Burlington and M. R. R. Co. v. Reinpackle*, 15 Neb. 279; *Cain v. C. R. I. and P. R. Co.*, 54 Iowa, 255; *Atchison and N. R. R. Co. v. Garside*, 10 Kan. 552; *Cadle v. Muscatine W. R. R. Co.*, 44 Iowa, 11. Compare *Buchner v. Chicago M. and N. W. Ry. Co.*, 69 Wis. 264; *aff'g S. C.*, 56 Wis. 403; *Bradley v. New York and N. H. R. R. Co.*, 21 Conn. 294. .

² See *People v. Kerr*, 27 N. Y. 188, 211.

³ *Railway Co. v. Lawrence*, 38 O. St. 41; *Railroad Co. v. Hambleton*, 40 O. St. 496; *G. C. & S. F. R. R. Co. v. Eddins*, 60 Tex. 656; *Gottschalk v. Chicago B. & Q. R. R. Co.*, 14 Neb. 550; *Jeffersonville M. & I. R. R. Co. v. Esterle*, 13 Bush (Ky.), 667; *Elizabethtown, etc. R. R. Co. v. Combs*, 10 Bush (Ky.), 382.

See also (cases in which the railroad company acted improperly) *Central Branch W. P. R. R. Co. v. Twine*, 23 Kan. 585; *Indianapolis B. & W. R. R. Co. v. Smith*, 52 Ind. 428; *Cross v. St. Louis K. C. & N. Ry. Co.*, 77 Mo. 318; compare *Porter v. Northern Missouri R. R. Co.*, 33 Mo. 128; *Pittsburgh & L. E. R. R. Co. v. Bruce*, 102 Pa. St. 23.

§ 176. The rights of abutting owners regarding the use of a public street in a city were carefully considered in *Story v. New York Elevated R. R. Co.*,¹ where the New York Court of Appeals assumed that the plaintiff did not own the fee of the street, but had only an easement based on a covenant made by the city with the plaintiff's grantor, whose deed was from the city, that the street should forever "continue and be for the free and common passage of, and as a public street and way for, the inhabitants of the said city, and all others passing through or by the same, in like manner as other streets of the same city now are or lawfully ought to be;" and, on this assumption, the court held that the building of an elevated railroad, which obscured to some extent the light of the plaintiff's abutting premises, and to some extent impaired their general usefulness and depreciated their value, deprived the plaintiff of rights for which he was entitled to compensation. The legislature might regulate the uses of the street as a street, but had no power to authorize a corporation to build thereon, without compensating the plaintiff, a structure subversive of and repugnant to the uses of the street as an open public street. Their decision would have been the same, the court said, if the fee of the street had been conveyed by the deed from the city to the plaintiff's grantor; for then the plaintiff would have possessed a private easement of a right of way in the street, with an express covenant that the entire street should be forever kept as a public street; though under such construction the covenant referred to would have been the covenant, not of the city, but of the city's grantee. No matter who was the covenantor, the plaintiff could not without compensation be deprived of his easement derived from the covenant. And even if the city held the fee to the street, the street was, nevertheless, held in trust to be used only as a public street.²

§ 177. In some cases a distinction is drawn between the liability of a private corporation, organized with a view to the

¹ 90 N. Y., 122; S. C., 11 Abb. N. C. 236. This case was affirmed and authoritatively expounded in *Lahr v. Metropolitan Elevated Ry. Co.*, 104 N. Y. 268.

² See *Railroad Co. v. Schurmeir*, 7 Wall. 272, 289; *Yates v. Milwaukee*, 10 Wall. 497, 504; *Cincinnati & S. G. Ave. Ry. Co. v. Cummins*, 14 Ohio St. 523, 546.

gain of the stockholders, to compensate for the inconvenience and damage it may cause individuals while acting within the scope of its powers; and the liability of a public corporation or officer to persons damaged through acts done by him or it in the performance of a purely public trust or office.¹ This distinction, whether proper or not, renders some of the decisions respecting the responsibility of municipal corporations for damages caused, for instance, in paving and grading streets, inapplicable to private corporations.²

Distinction between private and public corporations.

§ 178. In determining the value of property taken by a corporation, the same considerations are to be regarded as in the sale of property between private persons. The inquiry should be what is the property worth in the market, not merely with reference to the uses to which it is at the time applied, but also with regard to those to which it is plainly adapted.³ And the measure of compensation should be the difference between the market value of the property which is injured or taken, before and after the injury or taking.⁴

Measure of compensation.

¹ *Tinsman v. Belvidere Delaware R. R. Co.*, 26 N. J. L. 148; *Baltimore and Potomac R. R. Co. v. Reaney*, 42 Md. 117. A public corporation is one created for a political purpose. *Tinsman v. Belvidere Delaware R. R. Co.*, 26 N. J. L. 148. The whole interest in it must belong to the government. *Rundle v. Delaware, etc. Canal*, 1 Wall. Jr., 275, 290.

² See *Baltimore and Potomac R. R. Co. v. Reaney*, *supra*; *Smith v. Corporation of Washington*, 20 How. 135; *Transportation Co. v. Chicago*, 99 U. S. 635.

³ *Boom Co. v. Patterson*, 98 U. S. 403; *Hooper v. Savannah, etc. R. R. Co.*, 69 Ala. 529; *Shenango & A. R. R. Co. v. Braham*, 79 Pa. St. 447; *Mississippi Bridge Co. v. Ring*, 58 Mo. 491; *Henry v. Dubuque & P. R. R. Co.*, 2 Iowa, 288. See *Stinson v.*

Chicago St. P. & M. Ry. Co., 27 Minn. 284; *Selma R. & D. R. R. Co. v. Keith*, 53 Ga. 178; *Gear v. C. C. & D. R. Co.*, 39 Iowa, 23. Compare *Jacksonville & S. E. Ry. Co. v. Walsh*, 106 Ill. 253.

⁴ *Pittsburgh, etc. R. R. Co. v. Robinson*, 95 Pa. St. 426; *Pittsburgh, etc. R'y Co. v. Bentley*, 88 Pa. St. 178; *Hooper v. Savannah, etc. R. R. Co.*, 69 Ala. 529. See *Indianapolis, etc. R. R. Co. v. Pugh*, 85 Ind. 279; compare *Everett v. Union Pac. R. Co.*, 59 Iowa, 243; *Dreher v. I. S. W. R. Co.*, *ib.* 599; *Leber v. Minneapolis, etc. R'y Co.*, 29 Minn. 256. Where property taken by a corporation, by its right of eminent domain, is already deteriorated in value through the exercise of the right of eminent domain by another corporation, the damages must be estimated with reference to

When a portion of a tract of land belonging to one owner is taken, the just compensation should equal the fair market value of the land taken and the damage done to the rest of the tract by taking the land which is taken and operating a railroad thereon in a proper manner.¹ And the measure of this compensation is the difference between the fair market value of the whole tract before and after the railroad is built upon the strip taken.² Thus, when the construction of a railroad through a farm or other tract of land renders the use or cultivation of the remaining portions more inconvenient and expensive, this is an element of damage.³

the existing deterioration. *Lycoming Gas and Water Co. v. Moyer*, 99 Pa. St. 615. See generally *Mills on Eminent Domain*, Chap. XVI.

¹ *Bangor & P. R. R. Co. v. McComb*, 60 Me. 290; *Hooper v. Savannah*, etc. R. R. Co., 69 Ala. 529; *Robbins v. Milwaukee & H. R. R. Co.*, 6 Wis. 636; *Cincinnati & S. Ry. Co. v. Longworth*, 30 O. St. 108; *Wyandotte K. C. & N. W. Ry. Co. v. Waldo*, 70 Mo. 629; *Raleigh & A. Air Line R. R. Co. v. Wicker*, 74 N. C. 220; *Virginia & T. R. R. Co. v. Henry*, 8 Nev. 165; *White Water Valley R. R. Co. v. McClure*, 29 Ind. 536; *Baltimore P. & C. R. R. Co. v. Lansing*, 52 Ind. 229; *Hartshorn v. B. C. R. & N. R. Co.*, 52 Iowa, 613; *St. Louis, etc. R. R. v. Anderson*, 39 Ark. 167; *Texas & St. L. R. R. Co. v. Matthews*, 60 Tex. 215.

² *Pittsburgh & L. E. R. R. Co. v. Robinson*, 95 Pa. St. 426; *Pittsburgh V. & C. Ry. Co. v. Bentley*, 88 Pa. St. 179; *Danville H. & W. R. R. Co. v. Gearhart*, 81* Pa. St. 260; *Shenango & A. R. R. Co. v. Braham*, 79 Pa. St. 447; *Hornstein v. Atlantic & Gt. W. R. R. Co.*, 51 Pa. St. 87; *Harvey v. Lackawanna & B. R. R. Co.*, 47 Pa. St. 428; *East Pennsylvania R. R. Co. v. Hottenstein*, 47

Pa. St. 28; *Watson v. Pittsburgh & C. R. R. Co.*, 37 Pa. St. 469; *Schuylkill Navigation Co. v. Thoburn*, 7 S. & R. (Pa.) 411; *Henry v. Dubuque & P. R. R. Co.*, 2 Iowa, 288; *Sater v. Burlington, etc. Plank Road Co.*, 1 Iowa, 386; *Brooks v. Davenport & St. P. R. R. Co.*, 37 Iowa, 99; *Page v. Chicago M. & St. P. Ry. Co.*, 70 Ill. 324; *Bangor & P. R. R. Co. v. McComb*, 60 Me. 290; *Ham v. Wisconsin I. & N. Ry. Co.*, 61 Iowa, 716; *Black River, etc. R. R. Co. v. Barnard*, 9 Hun (N. Y.), 104; *Fleming v. Chicago D. & M. R. R. Co.*, 34 Iowa, 353; *Powers v. Hazelton, etc. R'y Co.*, 33 O. St. 429. Compare *St. Louis J. & S. R. R. Co. v. Kirby*, 104 Ill. 345; *St. Louis, etc. R. R. Co. v. Anderson*, 39 Ark. 167; *Reisner v. Atchison, etc. R. R. Co.*, 27 Kan. 382; *Henderson, etc. R. R. Co. v. Dickerson*, 17 B. Mon. (Ky.) 173; *Price v. Milwaukee & St. Louis Ry. Co.*, 27 Wis. 98; *Cincinnati & S. Ry. Co. v. Longworth*, 30 O. St. 108; *Hatch v. Vermont Central R. R. Co.*, 35 Vt. 49; *S. C.*, 28 Vt. 142; *Parker v. Boston & M. R. R.*, 3 Cush. (Mass.) 107; *Proprietors of Locks and Canals v. Nashua & L. R. R. Co.*, 10 Cush. 385.

³ *Tucker v. Massachusetts Central R. R.*, 118 Mass. 546; *Presbrey v.*

§ 179. When the property of a person is taken or injured, and the question is as to the amount of compensation, certain species of benefits which, concurring with the injury, may have lessened the actual depreciation of his property, are to be taken into consideration. If the whole of an owner's property in the vicinity is taken, manifestly no question can arise as to set-off of benefits. When a portion only of a tract or piece of land is taken, the benefits accruing to the rest of the tract may be set-off as against the damage done to it, but not as against the value of the portion taken:¹ and the benefits which may be set-off are

Old Colony & N. Ry. Co., 103 Mass. 1; McReynolds v. Burlington & O. R. Ry. Co., 106 Ill. 152; Robbins v. Milwaukee & H. R. R. Co., 6 Wis. 636; St. Louis, etc. R. R. v. Anderson, 39 Ark. 167; Watson v. Pittsburgh & C. R. R. Co., 37 Pa. St. 469; Sherwood v. St. Paul & C. Ry. Co., 21 Minn. 127; White Water Valley R. R. Co. v. McClure, 29 Ind. 536; Baltimore P. & C. R. R. Co. v. Lansing, 52 Ind. 229; Missouri Pacific Ry. Co. v. Hays, 15 Neb. 224; Raleigh, etc. R. R. Co. v. Wicker, 74 N. C. 220. Compare Atchinson & D. Ry. Co. v. Lyon, 24 Kan. 745; Curtis v. St. Paul, etc. R. Co., 20 Minn. 28; Ham v. Wisconsin I. & N. Ry. Co., 61 Iowa, 716; Bangor & P. R. R. Co. v. McComb, 60 Me. 290; Western Pennsylvania R. R. Co. v. Hill, 56 Pa. St. 460; Selma R. & D. R. Co. v. Camp, 45 Ga. 180; Pfeleger v. Hastings & D. Ry. Co., 28 Minn. 510.

¹ Robbins v. Milwaukee & H. R. R. Co., 6 Wis. 636; Chapman v. Oshkosh & M. R. R. Co., 33 Wis. 629; Neilson v. Chicago M. & N. Ry. Co., 58 Wis. 516; Fremont E. & M. V. R. R. Co. v. Whalen, 11 Neb. 585; Elizabethtown & P. R. R. Co. v. Helm, 8 Bush (Ky.), 681; Hayes v. Ottawa, etc. R. R. Co., 54 Ill. 373; Wilson v. Rockford, etc. R. R. Co., 59 Ill. 273; Todd v. Kankakee, etc. R. R. Co., 78 Ill. 530; Mayor, etc. of Atlanta v. Central Ry. Co., 53 Ga. 120; Jones v. Wills Valley R. Co., 30 Ga. 43; Shipley v. Baltimore, etc. R. R. Co., 34 Md. 336; Woodfolk v. Nashville, etc. R. R. Co., 2 Swan (Tenn.), 422; East Tennessee & V. R. R. Co. v. Love, 3 Head. (Tenn.) 63; Mississippi Ry. Co. v. McDonald, 12 Heisk. (Tenn.) 54; Grafton & G. R. R. Co. v. Foreman, 24 W. Va. 662; San Francisco, etc. R. R. Co. v. Caldwell, 31 Cal. 367; Henderson & N. R. R. Co. v. Dickerson, 17 B. Mon. (Ky.) 173; Alabama & F. R. R. Co. v. Burkett, 46 Ala. 569; Philadelphia & E. R. R. Co. v. Cake, 95 Pa. St. 139. Cases which do not sustain this rule are Britton v. D. M. O. & S. R. Co., 59 Iowa, 540; Brooks v. Davenport & St. P. R. R. Co., 37 Iowa, 99; Giesy v. Cincinnati, etc. R. R., 4 O. St. 308; Cincinnati & S. Ry. Co. v. Longworth, 30 O. St. 108; St. Louis, etc. R. R. v. Anderson, 39 Ark. 167; Isom v. Mississippi Central R. R. Co., 36 Miss. 300; New Orleans J. & G. N. R. R. Co. v. Moye, 39 Miss. 374; Brown v. Beatty, 34 Miss. 227. In these cases the set-off of benefits was

those only that are direct and peculiar to the tract of which a part is taken, and not shared by that tract in common with lands in the vicinity belonging to other owners.¹ The general rise of land in the neighborhood caused by building the railroad is not to be regarded, nor the benefits accruing to the owner of the tract through having the use of the railroad, when no greater privilege is given him than the railroad as a common carrier would be bound to furnish.²

§ 180. An act within the scope of the corporate powers done by the body corporate acting as such in the manner prescribed by the constitution of the corporation, is binding on all persons in any way interested in the

Acts of the
body corporate;
when binding.

held excluded by language of the state constitutions. The Massachusetts cases on the other hand permit set-off even as against value of the portion of land taken. *Meacham v. Fitchburgh R. R. Co.*, 4 Cush. (Mass.) 291; *Upton v. South Branch Reading R. R. Co.*, 8 Cush. (Mass.) 600; *Whitman v. Boston & M. R. R.*, 7 Allen (Mass.), 313; *Childs v. New Haven & N. Co.*, 133 Mass. 253; also a Minnesota case, *Winona & St. P. R. Co. v. Waldron*, 11 Minn. 515.

¹ *Childs v. New Haven, etc. Co.*, 133 Mass. 253; *Meacham v. Fitchburgh R. R. Co.*, 4 Cush. (Mass.) 291; *Upton v. South Branch Reading R. R. Co.*, 8 Cush. (Mass.) 600; *Shipley v. Baltimore, etc. R. R. Co.*, 34 Md. 336; *Fremont, E. & M. V. R. R. Co. v. Whalen*, 11 Neb. 585; *Woodfolk v. Nashville & C. R. R. Co.*, 2 Swan (Tenn.), 422; *East Tennessee & V. R. R. Co. v. Love*, 3 Head. (Tenn.) 63; *Winona & St. P. R. R. Co. v. Waldron*, 11 Minn. 515; *Hornstein v. Atlantic & Gt. W. R. R. Co.*, 51 Pa. St. 87; *Freedle v. North Carolina R. R. Co.*, 4 Jones, L. (N. C.) 89; *Raleigh & A. Air Line R. R. Co. v. Wicker*, 74 N. C. 220; *Hosher v. Kansas City, St. Jo. etc. R. R. Co.*,

60 Mo. 303; *Pacific R. R. Co. v. Chrystal*, 25 Mo. 544; *St. Louis & St. Jo. R. R. Co. v. Richardson*, 45 Mo. 466; *Alden v. White Mountains R. R.*, 55 N. H. 413; *Nicholson v. New York & N. H. R. R. Co.*, 22 Conn. 74, 88; *St. Louis, etc. R. R. Co. v. Morris*, 35 Ark. 622; *Mississippi Ry. Co. v. McDonald*, 12 Heisk. (Tenn.) 54; *St. Louis, etc. R. R. Co. v. Kirby*, 104 Ill. 345; *Upham v. Worcester*, 113 Mass. 97; *Peoria P. & J. R. R. Co. v. Black*, 58 Ill. 33; *Todd v. Kankakee, etc. R. R. Co.*, 78 Ill. 530. Contra, *Henderson, etc. R. R. Co. v. Dickerson*, 17 B. Mon. (Ky.) 173; see *California Pacific R. R. Co. v. Armstrong*, 46 Cal. 85.

² *Drury v. Midland R. R. Co.*, 127 Mass. 571. Compare *Pittsburgh & L. E. R. R. Co. v. Robinson*, 95 Pa. St. 426.

If the state constitution provides that when eminent domain is exercised by a railroad company, compensation must first be made the owner, the entry of a railroad company without the owner's permission is a trespass; except when the entry is made for a preliminary survey. *New Orleans, etc. R. R. Co. v. Jones*, 68 Ala. 48.

corporate enterprise; for the body corporate, expressing its will through a vote of a majority (in interest) of its members, or of a two-thirds or three-fourths majority if that majority is necessary in respect of any class of acts, possesses the ultimate power and discretion which the corporators as individuals, through incorporation, vested in themselves as a body corporate. This broad statement, however, which seems and is logical enough, is practically of less general application than what may be regarded as exceptions or qualifications to it. For the management of the affairs of a corporation is ordinarily vested by the corporate constitution in the board of directors; and this constitution embodying the original contract among the corporators is the final determinant of all rights and liabilities subsisting in respect of the corporate enterprise. Accordingly, if all the corporators or shareholders originally agreed that the management of the corporate enterprise should rest with the directors, it is incompetent for a majority of the shareholders to divest the directors of the management; at least as long as a single shareholder objects; for in such case to change the management of the corporate enterprise would violate the rights of the shareholders under the original agreement. And there is much reason in this, for manifestly the body of shareholders are incapable of managing the corporate business with efficiency. It is also to be remembered here, that as all persons dealing with a corporation are affected with knowledge of its constitution,¹ every one has notice of whatever incapacity the constitution has imposed on the body of shareholders.

§ 181. Accordingly, in one case where the enabling act contained the following provision: "the powers of the corporation shall be exercised by a board of trustees," a conveyance of real estate belonging to the corporation was held invalid because authorized by a shareholders' meeting;² and in another case, a lease of corporate property, authorized in the same manner, was set aside on the ground that the management having been vested in the board of directors, a shareholders' meeting was incompetent to authorize the lease.³

Acts of the
body corporate;
when held in-
valid.

¹ See § 195.

² *Gashwiler v. Willis*, 33 Cal. 12.

³ *Conro v. Port Henry Iron Co.*, 12 Barb. 27. But in this case the lease

§ 182. It is submitted, however, that any general rule which, from these cases, might be deduced as to the incapacity of shareholders to act in a corporate meeting, when the management is vested in a board of directors, is to be applied most cautiously.¹ A shareholders' meeting would rarely act except in regard to matters of vital importance to corporate interests; and there are certainly acts which the corporate constitution may authorize, that are beyond the authority of the board of directors, although the management is vested in the board.² Such acts—even if a shareholders' meeting would not by itself have been sufficient authority for them—if done by the directors, at least require for their validity the shareholders' ratification.³ And certainly the final authority of all in a corporation, to say whether the business shall be carried on or wound up, rests with the shareholders and not with the directors.⁴

§ 183. Unquestionably all the shareholders, or all the shareholders *and* creditors, acting unanimously, have more extensive powers than the body corporate acting by a majority, and may validly do acts which would have been invalid had they been done by the body corporate through an ordinary vote. Such acts, however, are rarely acts within the scope of the corporate powers; and it is only with doubtful propriety that they may be called acts of the corporation; for they are rather acts whereby the individuals interested in the corporate enterprise authorize or ratify what it was legally incompetent for the corporation as such to do.⁵

had been made to the principal shareholder for a nominal consideration, and was set aside at the suit of creditors on whom it was a fraud. It should have been set aside had its execution been perfectly regular. See also *Union Gold Mining Co. v. Rocky Mtn. Nat. Bk.*, 2 Col. 565; *McCullough v. Moss*, 5 Den. 567, 575; *Union Mut. Ins. Co. v. Keyser*, 32 N. H. 313, 315; *Dana v. Bank of U. S.*, 5 W. & S. 223, 245-247; *Dayton, etc. R. R. Co. v. Hatch*, 1 Disney (Cincinnati Sup'r Ct.), 84.

vested in the directors, a shareholders' meeting may appoint a committee to investigate the affairs of the corporation and incur the necessary expenses; for which the corporation will be liable. *Star Line v. Van Vliet*, 43 Mich. 364.

² *E. g.* Directors have no power to increase the capital stock, or lease the entire property of the corporation; see §§ 226-229.

³ See *Hancock v. Holbrook*, 9 Fed. Rep. 353.

⁴ See §§ 229, 230.

⁵ Compare *Railroad Co. v. Howard*, 7 Wall, 392. Such acts are *ultra*

¹ Although the management be

7 Wall, 392. Such acts are *ultra*

§ 184. To be valid in themselves acts done by the body corporate must be done in a corporate meeting duly assembled;¹ though any irregularity may be cured by the acquiescence of those who would have had the right to complain of it. In considering the relations between the corporation and outsiders dealing with it in good faith, this general rule requires modification. Great hardship would be worked if an outsider were compelled to see to it at his peril that all the formalities which the corporate body before action or in acting should observe were in fact observed. Accordingly, the non-observance of antecedent formalities in regard to notifying the meeting will not affect the rights of outsiders acting in good faith on the assumption that the corporate action was regular.² On the other hand it may be said, since ordinarily only acts of great importance are done by the body corporate, outsiders knowing the manner in which

Manner in which the body corporate should act.

vires; and their legal effect is the subject of Part III. of the present chapter. "Einstimmigkeit ist nur erforderlich bei Beschlüssen, welche über dem Corporationszweck hinausgehen; in Beschlüssen dieser Art handelt nicht die Corporation als solche, sondern es liegt in ihnen ein neuer constituirender Act der Corporationsmitglieder. Und auch Einstimmigkeit reicht zu Beschlüssen dieser Art in dem Falle nicht hin, wo die Corporation nicht lediglich in Privatinteresse ihrer Mitglieder besteht; sobald das öffentliche Interesse bei derselben betheiligt ist, ist die Gultigkeit auch des Einstimmigkeitsbeschlusses an die Staatsgenehmigung gebunden." Windscheid Pandekten, § 59.

¹ As to the manner of holding corporate meetings and elections, see §§ 573-576.

² See §§ 204, 259, for analogous principles applying to the acts of directors and other corporate officers.

If the corporate records show that a meeting was duly called on proper notice, and that business was transacted at the meeting, it is to be presumed, in the absence of direct contrary evidence, that a quorum was present. *Citizens' Ins. Co. v. Shortwell*, 8 Allen, 217. See *Sargent v. Webster*, 13 Metc. 497; *Chouteau Ins. Co. v. Holmes*, 68 Mo. 601. At a meeting duly convened, a majority of those present have power to transact business, though they are a minority of the whole number, *Granger v. Grubb*, 7 Phila. 350.

Still, it has been held that a vote purporting to authorize an agent of the corporation to convey its real estate, passed at a meeting which had not been notified to the holders of about one-third of the stock, was void; and gave no validity to a deed executed pursuant to it; but the case was actually decided on another point. *Stowe v. Wise*, 7 Conn. 214.

corporations usually act, ought carefully to examine the proceedings of the body corporate when their rights are to be based directly on its action.

§ 185. Further, if there are in the constitution of a corporation provisions of an imperative nature relating to the action of shareholders, every one will be affected with notice of them, and bound at his peril to see to it that they are observed. Thus, when a statute requires the assent of two-thirds of the shareholders present in a shareholders' meeting as a condition to a lease of a railroad, a lease executed without such assent is invalid.¹ In like manner, where under its enabling act a corporation is authorized to mortgage its property, having first obtained the written consent of the owners of two-thirds of the capital stock, this written consent is a condition precedent to the validity of a mortgage executed by the corporation; and the corporation itself cannot give consent on behalf of stock held by itself, nor can the assenting shareholders be deemed to represent a proportionate amount of the stock held by the corporation.² Still, in another case,³ it was held by the same court construing the same statute, that where there is no fraud, the defects in the execution of the consent must, to invalidate it, be so radical that an intention to consent cannot be inferred. In this case the objection was interposed by the holder of a subsequent mortgage, and the court said: "Without consider-

¹ *Peters v. Lincoln and N. W. R. R. Co.*, 2 McCrary, 275.

² *Vail v. Hamilton*, 85 N. Y. 453. Such a mortgage may be set aside at the suit of a receiver, the corporation being insolvent. *Ib.*

The two last points stated in the text were not necessary to the decision of this case; for even if the corporation could validly have consented on behalf of the shares held by it, or if those shares had been deducted from the total amount of its stock, still there would not have been a representation of two-thirds of the stock; for some of

the shares on which the corporation purported to consent, and which were needed to make up the two-thirds, it had reissued to an individual by a transfer absolute in form, though made as collateral security. Compare *Greenpoint Sugar Co. v. Whitin*, 69 N. Y. 328, 339, *infra*. Still, it is settled that a corporation cannot vote on shares held by it. § 136.

³ *Greenpoint Sugar Co. v. Whitin*, 69 N. Y. 328. See *Paulding v. Chrome Steel Co.*, 94 N. Y. 334. Compare *Lewis v. Jeffries*, 86 Pa. St. 340.

ing the question whether any but stockholders may interpose the objection to the authority exercised in this case, the inference that the general purpose and design of the act was in the interest of stockholders only has some bearing on the question presented as to the proper rule of construction to be adopted of the paper produced as the assent of the stockholders."¹ The consent, of which the validity was before the court, had been signed by the owners of two-thirds of all the stock that had ever been issued; and, although they were not the holders of two-thirds of the amount of stock specified in the articles of incorporation, they represented, as the court said, "two-thirds of the pecuniary interest and property of the corporation."² And the consent was held sufficient, notwithstanding other alleged defects, all of which the court considered immaterial under the circumstances of the case.³

§ 186. Further principles of law are to be taken into consideration when it is the function of certain officers to certify the existence of an assent of shareholders to a measure. Then it would seem, although the assent might be defective or perhaps entirely wanting, that the certification of the proper officer would estop the corporation from setting up either of these facts to the detriment of an outsider who had acted in good faith relying on the certification.⁴

Certification of the performance of formalities.

¹ 69 N. Y. 333. See § 813. This same statute provides that the assent "shall first be filed in the office of the clerk of the county where the mortgaged property is situated." Under this, as against a subsequent mortgagee with notice of the prior mortgage, an assent given *after* the execution of the prior mortgage validates it, although not filed in the office of the proper county clerk, such assent being prior in time to the subsequent mortgage. *Rochester Savings Bank v. Averell*, 96 N. Y. 467.

² 69 N. Y. 339.

³ Where for the validity of a mortgage, a statute requires the concur-

rence of two-thirds of the shareholders present at a meeting, it is sufficient if all the directors assent at a directors' meeting, they being in fact all the shareholders but one. *Thomas v. Citizens' Horse R'y Co.*, 104 Ill. 462. The court said that all the shareholders had assented; and the corporation had had the proceeds of the mortgage. Compare *Miller v. Rutland, etc. R. R. Co.*, 36 Vt. 452.

⁴ See §§ 207, 208 for analogous principles which estop a corporation from denying the existence of a fact certified to by an agent, on the existence of which the authority of the agent to act depends; also, §§ 329-332.

Individual
sharehold-
ers cannot
act for the
corpora-
tion.

§ 187. Shareholders separately and individually have no power to act for the corporation; and acts done by them in such a manner will have no validity as corporate acts;¹ unless, to be sure, a shareholder acts under some special authority, in which case he does not act as a shareholder. This statement, however, requires modification in this respect; shareholders by their separate and individual action or acquiescence may estop themselves from questioning the validity of an act done on behalf of a corporation.² Conversely, a person owning all the capital stock of a corporation is not the legal owner of its property, and cannot maintain replevin for it is in his own name.³

Validity of
the acts of
de facto
officers.

§ 188. Before entering on the discussion of what acts of the various classes of corporate officers are binding on the corporation it will be convenient to notice how the validity of an act is affected by the circumstance that the person acting on behalf of the corporation as a corporate agent or officer is not in point of strict law the

¹ *Shay v. Tuolumne County Water Co.*, 6 Cal. 73; *Ruby v. Abyssinian Society*, 15 Me. 306; *Bartlett v. Kinsley*, 15 Conn. 327; *Hartford Bank v. Hart*, 3 Day (Conn.), 491; *Hayden v. Middlesex Turnpike Co.*, 10 Mass. 397, 403; *Harris v. Muskingum M'fg Co.*, 4 Blackf. (Ind.) 267. See *Canal Bridge v. Gordon*, 1 Pick. 296, 303; *Bidwell v. Pittsburgh, etc. Ry. Co.*, 114 Pa. St. 535. All the shareholders acting individually cannot convey the corporate lands. *Wheelock v. Moulton*, 15 Vt. 519; *Isham v. Bennington Iron Co.*, 19 Vt. 230, 249; *Baldwin v. Canfield*, 26 Minn. 43. Compare *Gordon v. Swan*, 43 Cal. 564; *Castleberry v. State*, 62 Ga. 442. So a person who is president, treasurer, and general manager of a corporation and owns all but two shares of its stock, cannot give a mortgage of the property of the corporation to secure a pre-existing debt; *England v. Dear-*

born, 141 Mass. 590. *Semble contra*, *Swift v. Smith*, 65 Md. 428. So a sale of corporate property made in good faith by the assignee of an insolvent corporation cannot be set aside on account of any fraud committed by a shareholder, with which the assignee was in no way connected. *Trevitt v. Converse*, 31 Ohio St. 60. Notice to individual shareholders is not notice to the corporation. *Davis Improved Wrought Iron Wagon Wheel Co. v. Davis, etc. Co.*, 22 Blatchf. 221.

But if the shareholders covenant that the corporation shall do certain acts they will be individually liable, at least in damages, if it do not perform. *Tileston v. Newell*, 13 Mass. 406; see *Wheelock v. Moulton*, 15 Vt. 519, 524.

² *Sheldon Hat Blocking Co. v. Eickemeyer Hat Blocking Machine Co.*, 90 N. Y. 607. See §§ 213-217.

³ *Button v. Hoffman*, 61 Wis. 20.

officer he purports to be—is an officer *de facto*, and not an officer *de jure*.¹

“An officer *de facto*,” says Lord Ellenborough, “is one who has the reputation of being the officer he assumes to be, and yet is not a good officer in point of law.”² It is consistent with this definition, and has been so held, that by color of election a person, though clearly ineligible, may be such an officer.³ Moreover, “persons acting publicly as officers of the corporation are presumed to be rightly in office. . . . If officers of the corporation openly exercise a power which presupposes a delegated authority for the purpose, and other corporate acts show that the corporation must have contemplated the legal existence of such authority, the acts of such officers will be deemed rightful, and the delegated authority will be presumed. If a person acts notoriously as cashier of a bank, and is recognized by the directors or by the corporation as an existing officer, a regular appointment will be presumed; and his acts, as cashier, will bind the corporation, although no written proof is or can be adduced for his appointment.”⁴

Mere general reputation, however, is not evidence as against the corporation, to prove that certain persons were its officers (directors), the ordinary rules of evidence being applicable.⁵

§ 189. The general rule regarding the legal effect of the acts of *de facto* officers is stated in Angell and Ames on Corporations, as follows: “The act of an officer *de facto* is good, wherever it concerns a third person, who had a previous right to the act, or has paid a valuable consideration for it; and this, whether the act concerns the preservation of the corporation or not.”⁶

Principles on which rests the validity of the acts of *de facto* officers.

¹ In regard to setting aside the appointment or election of *de facto* officers, see §§ 577–581.

² *King v. Bedford Level*, 6 East, 356, 368; see *Parker v. Kett*, 1 L'd Raymond, 658, 660. This definition is followed in *Mechanics' Nat. Bank v. Burnett M'fg Co.*, 32 N. J. Eq. 236. Compare *Norton v. Shelby County*, 118 U. S. 425.

³ *Knight v. Corporation de Wells*

Lüt., 508, 519. See, also, *O'Brian v. Knivan*, Cro. Jac. 552.

⁴ *Story, J.*, in *Bank of U. S. v. Dandridge*, 12 Wheat. 64, 70. In accord with his remarks are *Hall v. Carey*, 5 Ga. 239; *Despatch Line v. Bellany M'fg Co.*, 12 N. H. 205.

⁵ *Litchfield Iron Co. v. Bennett*, 7 Cow. 234.

⁶ § 287. See *Riddle v. Bedford County*, 7 S. & R. 386, 392; *Greené*

It is submitted that this statement of the rule does not give sufficient prominence to the principle of estoppel on which the rule depends; a principle which, in its application to the responsibility of corporations for the acts of *de facto* officers, may be stated thus: If a body of men acting as a corporation permit certain persons to act openly as corporate officers—or if it is permitted by the directors, assuming them to have had the power to appoint the officer in question—the corporation will not, to the detriment of persons who in good faith have acted on the assumption that the persons acting as officers were the officers they assumed to be, be permitted to impeach the validity of their acts and contracts on the ground that such persons were not legally corporate officers;¹ and, on the other hand, persons who contract with *de facto* officers as officers of the corporation will not, when sued by the corporation on the contract, be allowed to defend on the ground that such officers were not legally the representatives of the corporation.²

§ 190. Both branches of the foregoing proposition rest on principles of estoppel; and with the limits of the estoppel the scope of their application is determined. Consequently, to an action for calls, a shareholder may plead that the directors making the calls were not legally

Limitations.

v. Sprague M'f'g Co., 52 Conn. 330. Of course, an outsider, having no standing in court to do so, cannot impeach the validity of the acts of a *de facto* officer. See *Simpson v. Garland*, 76 Me. 203.

¹ *Baird v. Bank of Washington*, 11 S. & R. 411; *Heath v. Silverthorn Lead Mining Co.*, 39 Wis. 147; *Mechanics' Nat. Bk. v. Burnet M'f'g Co.*, 32 N. J. Eq. 236; *Hackensack Water Co. v. De Kay*, 36 N. J. Eq. 548; *San José Savings Bank v. Sierra Lumber Co.*, 63 Cal. 179. *In re County Life Assurance Co.*, L. R. 5 Ch. 288; see *Stratton v. Lyons*, 53 Vt. 130; *Newton M'f'g Co. v. White*, 42 Ga. 148.

A familiar application of this rule is to the case where legally elected offi-

cers hold over after the expiration of their terms of office. The acts of such officers bind the corporation as to outsiders acting in good faith.* *Thorington v. Gould*, 59 Ala. 461; *St. Louis Domicile Ass'n v. Augustin*, 2 Mo. App. 123. *Milliken v. Steiner*, 56 Ga. 251. So persons dealing with an insurance agent may assume the continuance of his authority until in some way informed of its revocation. *Insurance Co. v. McCain*, 96 U. S. 84. See also cases cited in the preceding and following notes.

² *Delaware, etc. Canal Co. v. Pennsylvania Coal Co.*, 21 Pa. St. 131; *Cooper v. Curtis*, 30 Me. 488; *Imboden v. Etowah, etc. M'g Co.*, 70 Ga. 86. See *Simpson v. Garland*, 76 Me. 203; *Abbott v. Chase*, 75 Me. 83.

elected ;¹ and a forfeiture of shares declared by illegally chosen directors may be set aside.² It is also held that the principle on which the validity of the acts of *de facto* officers is sustained against the corporation does not apply where all the persons affected have notice that the officers assuming to act were not legally chosen.³

§ 191. There are certain rules of general application regarding the responsibility of corporations for the act of their agents, which it will be well to consider before discussing in detail the authority of the different classes of corporate agents.

General rules regulating the responsibility of corporations for the acts of their agents.

§ 192. The acts of directors and other corporate agents are valid as to the corporation and all persons interested in the corporate enterprise, when the directors or other agents act in pursuance of powers originally conferred on them by the charter, or enabling statute and articles of association ; or conferred on them through an exercise of power vested in the body corporate or—in the case of agents other than the board of directors—in the board of directors. And where a competent authority is expressly conferred on an agent for a certain purpose, he will have incidentally authority

¹ People's Mutual Ins. Co. v. Westcott, 14 Gray, 440; Howbeach Coal Co. v. Teague, 5 H. & N. 151. Quære, supposing the only shareholders disputing the call had taken part without objection in the election of the directors, and voted for them.

It has been held, where directors were elected at a meeting of shareholders not called by the persons named in the certificate of incorporation, that a subscriber when sued on his subscription cannot plead that the directors were not legal officers. The statute in this respect being but directory, the validity of the directors' acts could not thus be questioned collaterally. Chamberlain v. Painesville, etc. R. R. Co., 15 Ohio St. 225. See § 540.

² Garden Gully Mining Co. v. McLister, L. R. 1 App. Cas. 39.

³ State v. Curtis, 9 Nev. 325; Orr Water Ditch Co. v. Reno Water Co., 17 Nev. 166.

It has also been held that, though the acts of a president *de facto* would be valid "for ordinary purposes," yet when a suit by which he was eventually ousted was pending to try his title to the office, he could not make a valid assignment of securities belonging to the corporation, with a view to making preferences between creditors. Walker v. Flemming, 70 N. C. 483.

Quære, would the making of such an assignment have been in the power of a president *de jure*? See §§ 236 et seq.

to do whatever acts are necessary and proper to carry out the purpose of his appointment.¹

§ 193. If directors or other corporate agents do an act which

Rules of the law of agency applicable. Acts within the ordinary scope of the agent's authority valid.

is not beyond the scope of the corporate powers, the question whether the act is binding on the corporation and all persons interested in the corporate enterprise, may be usually solved by an application of the ordinary rules of agency. If the act was within the ordinary scope of the agent's authority, and the other party acted in good faith, having no notice that the agent had in fact no authority to do the act in ques-

tion, the corporation will be bound by the act, unless the powers of the agent are contained in some instrument (*e. g.*, the charter), with knowledge of the contents of which the other party was affected; for a person dealing with a corporate agent is justified in assuming that the agent has authority to do any act or make any contract within the scope of his employment and incidental thereto.² As Justice Story said, giving the opinion of the court

¹ A general power conferred on the president of a railroad company to borrow money for it, and purchase rails, locomotives, etc., and in order to do so, to make and deliver obligations, bills of exchange, and contracts of the company, includes authority to give securities to a lender or a vendor. *Hatch v. Coddington*, 95 U. S. 48.

² See, *e. g.*, *Fletcher v. New York Life Ins. Co.*, 14 Fed. Rep. 846; *Adams Exp. Co. v. Schlesinger*, 75 Pa. St. 246; *Great Western Ry. Co. v. Miller*, 19 Mich. 305. Thus, station agents are presumed to have authority to contract for the transportation of freight; and shippers are not affected with notice of limitations on their powers unless the limitations are conveyed to the public in a manner authorizing the inference that shippers are apprised of them. *Pruitt v. Hannibal and St. Jo. R. R. Co.*, 62 Mo. 527; *Harrison v. Missouri Pacific Ry. Co.*, 74 Mo. 364; *Watson*

v. Memphis, etc. R. R. Co., 9 Heisk. (Tenn.) 255; *Michigan Southern & N. I. R. R. Co. v. Day*, 20 Ill. 375. But compare *Wood v. C. M. and St. P. Ry. Co.*, 59 Iowa, 196; *Burroughs v. Norwich, etc. R. R. Co.*, 100 Mass. 26; *Missouri Pac. Ry. Co. v. Stults*, 31 Kan. 752; *Wood v. C. M. & St. P. Ry. Co.*, 59 Iowa, 196. Passengers may assume that baggage-masters have authority to make all ordinary contracts and arrangements connected with the transportation of baggage. *Isaacson v. N. Y. C. & H. R. R. R. Co.*, 94 N. Y. 278. So general or division superintendents, or general agents of a railroad company may be presumed to have authority to employ a physician to attend an employé injured in the service of the company. *Atlantic and Pac. R. R. Co. v. Reisner*, 18 Kans. 458; *Pacific R. R. Co. v. Thomas*, 19 Kans. 256. Compare *Louisville E. & St. L. Ry. Co. v. McVay*, 98 Ind. 391; *Union Pacific Ry. Co. v. Beatty*, 35 Kan. 265.

in *Minor v. Mechanics' Bank*,¹ "The officers of the bank are held out to the public as having authority to act, according to the general usage, practice, and course of their business; and their acts within the scope of such usage, practice and course of business, would, in general, bind the bank in favor of third persons possessing no other knowledge."²

Further, from the circumstance that a corporate agent or officer for a space of time has performed certain acts on behalf of the corporation, with its acquiescence or with the acquiescence of his superior officers, who themselves have authority to do the acts in question, persons dealing with him will be protected in acting on the honest assumption that those acts and acts of a like nature done for a similar purpose are within the scope of his authority.³

§ 194. In the present connection it is of great importance to determine what limitations on the authority of corporate agents will protect a corporation from responsibility for their unauthorized acts. Limitations having

Effective
limitations
on the
authority

But a station agent or conductor has no such authority, § 201. See also *Insurance Co. v. McCain*, 96 U. S. 84, and cases in the following notes.

¹ 1 Pet., 46, 70.

² Thus, where a person pays a debt over the bank-counter to an officer who was paying and receiving teller of the bank, without knowledge that he is not authorized to receive the money, the bank is bound by the payment. *East River National Bank v. Gove*, 57 N. Y. 597. See *Hotchkiss v. Artisans' Bank*, 2 Keyes, 564. So an agent for an insurance company, authorized to take and approve risks and to insure, is authorized by general usage to allow credit for the premium. Its allowance does not impair the validity of the preliminary contract to insure. *Insurance Co. v. Colt*, 20 Wall. 560. And a corporation may be held on promissory notes issued by its treasurer in accordance with usage. *In re Great Western Telegraph Co.*, 5 Biss. 363.

Compare, as to treasurer's authority, *Atkinson v. St. Croix M'f'g Co.*, 24 Me. 171; *Stark Bank v. U. S. Pottery Co.*, 34 Vt. 144.

³ *Mining Co. v. Anglo-Californian Bank*, 104 U. S. 192; *Creswell v. Lanahan*, 101 U. S. 347; *Merchants' Bank v. State Bank*, 10 Wall. 604; *Beers v. Phoenix Glass Co.*, 14 Barb. 358; *Phillips v. Campbell*, 43 N. Y. 271; *Talladega Insurance Co. v. Peacock*, 67 Ala. 253; *Lester v. Webb*, 1 Allen, 34; see *Allen v. Citizens' Steam Navigation Company*, 22 Cal. 28; *Lee v. Pittsburgh Coal, etc. Co.*, 56 How. Pr. (N. Y.) 373; S. C., aff'd 75 N. Y. 601; *Woman's Christian Temperance Union v. Taylor*, 8 Col. 75; and generally the principles of estoppel apply to corporations. *Bank v. Flour Co.*, 41 O. St. 552; *New York & N. E. R. R. Co. v. New York, etc. R. R. Co.*, 52 Conn. 274, 282.

Compare *Elliott Bank v. Western, etc. R. R.*, 2 Lea (Tenn.), 676.

of corporate agents.

this effect may be divided into three classes: first, those with knowledge of which persons transacting business with corporate agents are affected as a matter of law; secondly, those actually brought to the knowledge of such persons; and, thirdly, those a reasonable man would infer from the character of the agent's employment.

§ 195. It is undisputed that persons dealing with a corporation are charged with notice of the limitations on the

Class I.

authority of its agents contained in its charter or enabling act and articles of association.¹ And a person dealing with a domestic corporation is also charged with knowledge of the general law regulating corporations, statutory as well as unwritten.² Further, where a certain class of corporations, for instance banks, have established, recognized, and well-known usages, all persons dealing with their agents will be affected with notice of these usages, and the contracts of such corporations will be construed with reference to them.³

¹ *Pearce v. Madison, etc. R. R. Co.*, 21 How. 441, 443; *Davis v. Old Colony R. R. Co.*, 131 Mass. 258; *Beatty v. Marine Ins. Co.*, 2 Johns. (N. Y.) 109; *Dabney v. Stevens*, 2 Sweeney, 415, aff'd 46 N. Y. 681; *Adrian v. Roome*, 52 Barb. 399; *Silliman v. Fredericksburg, etc. R. Co.*, 27 Gratt. (Va.) 119; *Merritt v. Lambert*, 1 Hoffman's Ch. (N. Y.) 165; *Root v. Wallace*, 4 McLean, 8; *Salem Bank v. Gloucester Bank*, 17 Mass. 1, 29; see *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381, 398.

The English law is similar in this respect. *In re County Life Assurance Co.*, L. R. 5 Ch. 288, 293; *Royal British Bank v. Turquand*, 6 El. & Bl. 327; *Ernest v. Nicholls*, 6 H. L. C. 401, 419; *Fountaine v. Carmarthen Ry. Co.*, L. R. 5 Eq. 316, 322.

² A party dealing with the agents of a foreign corporation must take notice of every limitation in its charter; but is not affected with notice of statutes of

a general nature enacted by the foreign state, though they tend to abridge the corporate powers. *Hoyt v. Thompson's Exr.*, 19 N. Y. 207; see *Bank of Chillicothe v. Dodge*, 8 Barb. 233. But see *City Fire Ins. Co. v. Carrugi*, 41 Ga. 660.

A person dealing with the directors of a foreign (English) corporation is affected with notice of the limitations on their authority contained in the articles of association. *Davis v. Flagstaff Silver Mining Co.*, 2 Utah, 74; compare *Flagstaff Silver Mining Co. v. Patrick*, ib. 304.

³ *Renner v. Bank of Columbia*, 9 Wheat. 581; *Lincoln, etc. Bank v. Page*, 9 Mass. 155; *Smith v. Whiting*, 12 Mass. 6. See *Blanchard v. Hilliard*, 11 Mass. 85; *Weld v. Gorham*, 10 Mass. 366; *Jones v. Fales*, 4 Mass. 245; *Whitwell v. Johnson*, 17 Mass. 452; *City Bank v. Cutter*, 3 Pick. 414; *Haddock v. Citizens' Nat. Bank*, 53 Iowa, 542. Compare *Jackson Ins. Co. v. Cross*, 9 Heisk. (Tenn.) 283.

§ 196. In regard to by-laws, it is impossible to state any rule of universal or even general applicability; for whether a person dealing with a corporation is affected with notice of its by-laws depends greatly on the position they fill in the scheme of organization and incorporation of the company prescribed by its enabling act. It has perhaps been held that all persons dealing with corporate agents are charged with notice of the limitations on their authority contained in the by-laws.¹ But this proposition, thus broadly stated, is not generally accepted as law. Indeed, the weight of authority is in favor of the general rule that outsiders are not charged with knowledge of the by-laws of a corporation.² An examination of the *ratio decidendi* of a few cases may point to some rule on this important point. *Smith v. Smith*³ holds that outsiders are not affected by the by-laws of a corporation, because "these are private, and only accessible to the officers of the company." So in *Samuel v. Holladay*⁴ it was held that a by-law made by a board of directors for their own government, providing how special meetings of the board should be called, could not affect contracts made with third persons having no actual notice of the by-law; Justice Miller saying that the effect of such a by-law on outsiders differed from the effect of "by-laws made by the stockholders at the annual or stated meeting, under authority and direction of a provision of the charter."⁵

§ 197. The principle underlying these decisions seems to be that a stranger should not be charged with knowledge of by-

¹ *Adriance v. Roome*, 52 Barb. 399, 411; *Dabney v. Stevens*, 2 Sweeny (N. Y.) 415; *De Bost v. Albert Palmer Co.*, 1 How. Pr. N. S. (N. Y.) 501. In these cases, however, the decision seems to have turned rather on the fact that the act in question was beyond the scope of the authority of the officers doing it, coupled with the absence of circumstances from which authority might reasonably have been inferred.

² *Fay v. Noble*, 12 Cush. 1; *Ten Broek v. Boiler Compound Co.*, 20 Mo. App. 19; and cases in the follow-

ing notes. See also *Kingsly v. New England Ins. Co.*, 8 Cush. 393, 403; *Mechanics*, etc. *Bank v. Smith*, 19 Johns. 115. *In re Asiatic Banking Corp.*, *Royal Bank of India's Case*, L. R. 4 Ch. 252; *Anglo-California Bank v. Grangers' Bank*, 63 Cal. 359; *Gordon v. Muchler*, 34 La. Ann. 604. Last case holding depositor in bank not bound by by-law.

³ 62 Ill., 493, 497.

⁴ 1 Woolw. 400, 408; S. C., *MacCahon*, 214.

⁵ See *Cummings v. Webster*, 43 Me. 192.

laws because of the difficulty he would have in acquainting himself with them, and because the authority of the corporation to make by-laws was not intended to affect the rights of outsiders.¹ But suppose the statutes regulating the organization of the company require the by-laws to be passed at the first meeting of the subscribers or shareholders, and, together with the articles of association, to be filed with some public official like the secretary of state or a county clerk.² Under such circumstances there is nothing private about the by-laws. Any stranger may examine them. Moreover, by requiring the by-laws to be filed with the articles of association, the legislature indicates its intention that they shall be open to the inspection of all; and every reason for holding outsiders charged with knowledge of the articles of association is a reason for holding them charged with knowledge of by-laws filed with the articles. Accordingly, it would seem reasonable that persons dealing with the officers of a corporation should be charged with notice of by-laws which, in pursuance of the enabling act, are filed in a public place for public inspection.

Finally, whether outsiders are charged with notice of the by-laws or not, if a course of action unauthorized with reference to some by-law is acquiesced in by the corporation, the by-law will not affect the rights of an outsider acting in good faith.³

§ 198. The next class of restrictions on the authority of corporate agents which are effectual in protecting the corporation from the consequences of an agent's exceeding his authority, are those which are brought to the actual knowledge of the party dealing with the corporate agent before the act is done wherein it is alleged that the agent exceeded his authority. An express limitation on the authority of a corporate agent brought to the actual notice of any person dealing with him will, in respect of the matter to which the limitation

¹ See *Mechanics', etc. Bk. v. Smith*, 19 Johns. 115, 124.

² As, *e. g.*, in the New York Business Companies Act, ch. 611, laws of 1875.

³ *Phillips v. Campbell*, 43 N. Y. 271; *Emery v. Boston Marine Ins.*

Co., 138 Mass. 398; *Donovan v. Halsey Fire Engine Co.*, 58 Mich. 38; compare *Knight v. Lang*, 4 E. D. Smith (N. Y.), 381; *Jackson v. Campbell*, 5 Wend. 572.

refers, protect the corporation from any liability arising *ex contractu* from its agent's unauthorized acts.¹ The efficacy for the protection of the corporation of this class of limitations depends on the actual knowledge of the person contracting with the corporate agent;² and the burden is on the corporation to prove knowledge on the part of such person, unless the circumstances are such that his knowledge may reasonably be presumed.³ Any special or private instructions to the corporate agent, uncommunicated to the person dealing with him, will not affect the rights of such person against the corporation.⁴

§ 199. It may be added here, that when reasonable regulations have been competently made by the proper corporate authority with special reference to the dealings of outsiders with the corporation through its agents, all persons having knowledge of the regulations will be bound by them in contracting and dealing with the corporation. Thus, where in making a deposit in a savings bank, the depositor receives a pass-book containing a printed rule that no depositor shall be paid without producing the pass-book, and that payments made to the bearer of the pass-book shall be deemed good and valid payments to the depositor, a payment made in accordance with the rule binds the depositor, although his signature to a draft or order may have been forged; providing the officers of the bank are guilty of no negligence.⁵

§ 200. The third class of effective restrictions arise from the nature of the agent's employment as indicating the scope of his authority. If an act is beyond the ordi-

Class III.

¹ *Marvin v. Universal Life Ins. Co.*, 85 N. Y. 278.

² *Insurance Co. v. McCain*, 96 U. S. 84.

³ See § 193, and compare §§ 358, 359.

⁴ *Insurance Co. v. McCain*, *supra*; *Fay v. Noble*, 12 Cush. 1.

⁵ *Schoenwald v. Metropolitan Savings Bk.*, 57 N. Y. 418; *Appleby v. Erie County Savings Bk.*, 62 N. Y. 12; *Sullivan v. Lewiston Institution of Savings*, 56 Me. 507. Compare *Man-*

hattan Co. v. Lydig, 4 Johns. 377; *Kimball v. Norton*, 59 N. H. 1.

Likewise may the depositors rely on the by-laws in such case; and when a savings bank pays money to the wrong person, and, in so doing, acts in contravention of its by-laws, it will be liable. *People's Savings Bk. v. Cupps*, 91 Pa. St. 315. In this case the forged order was not witnessed as required by the by-laws. Compare *State v. Atherton*, 40 Mo. 209; *Morris Canal, etc. Co. v. Van Vorst*, 21 N. J. L. 100.

nary scope of the agent's employment and authority, and was not in fact authorized by the corporation, nor by superior officers who themselves have authority to do or authorize it, the corporation will not be bound; for the power to bind the corporation may be presumed to exist in its agents and officers only in regard to acts within the scope of its ordinary business and their ordinary duties.¹ And when a corporate agent, without actual authority, exceeds the powers which an outsider from the agent's employment may reasonably suppose him to possess, the corporation is not estopped from repudiating the unauthorized act.²

§ 201. The following are instances of the last class of restrictions: A general insurance agent will not bind his company by accepting articles of personal property in satisfaction of a premium payable in money.³ Station agents and conductors of a railroad company have no authority, by virtue of their positions, to employ a physician at the expense of the company for a brakeman injured by its cars.⁴ Nor has a ticket agent at a way station authority to modify the terms of a through ticket.⁵ Nor is a railroad company liable for advances made by a commission merchant on the faith of a bill of lading fraudulently signed by one of its station agents, when the goods described in the bill had not been received at the station for transportation; for every one must be held to know that a station agent has no power to give bills of lading for goods not received by him, and must ascertain whether the goods⁶ have in fact been shipped.⁶ Proof that a person was the general agent of a corporation in charge of its business at a certain place, shows no authority in him to execute a bill or note on behalf

¹ *First Nat. Bk. v. Ocean Nat. Bk.*, 60 N. Y. 278.

² *Fawcett v. New Haven Organ Co.*, 47 Conn. 224.

³ *Hoffman v. Hancock Mut. Life Ins. Co.*, 92 U. S. 161. Compare *Hackney v. Allegheny County Mut. Ins. Co.*, 4 Pa. St. 185.

⁴ *Tucker v. St. Louis, K. C. and N. Ry. Co.*, 54 Mo. 177. But see *Terra Haute & I. R. R. Co. v. McMurray*,

98 Ind. 358. But a division superintendent has. *Ante*, § 193, note.

⁵ *McClure v. Philadelphia, etc. R. R. Co.*, 34 Md. 532.

⁶ *Balto. and Ohio R. R. Co. v. Wilkens*, 44 Md. 11. But in this case the station agent was the merchant's own correspondent, and the goods purported to have been shipped by the station agent himself. Compare § 193, note.

of the corporation.¹ A "general agent" has no implied authority to transfer the real estate of the corporation;² nor has a general superintendent and manager.³ A secretary of a mining company has no authority, *ex officio*, to assign a note belonging to the company;⁴ nor the secretary of an insurance company to sign a draft on its behalf.⁵ And officers of a bank have no authority to waive service of a petition filed by the attorney-general to forfeit its franchises.⁶

§ 202. It is of importance to bear in mind that the authority of an officer, as indicated by his office, does not depend so much on his title or the theoretical nature of his office, as on the duties he is in the habit of performing.⁷ Accordingly, the general managing officer of a corporation, be he styled "president," "superintendent," or "agent," from the circumstance that he has general charge of the business, will possess extensive powers that might not be possessed by an officer of another company holding the same title.⁸ Thus, where compromises of debts are matters of common occurrence with a certain bank, a court will presume, in the absence of affirmative proof to the contrary, that the cashier and the president, who are its active managers, have power together to compromise a claim.⁹ So the officers managing the affairs of a corporation have authority, without a formal vote of the board of directors, to employ counsel.¹⁰ And it has been held that a

Authority of agent depends on his actual functions, rather than on the name of his office.

¹ *Atkinson v. St. Croix M'fg Co.*, 24 Me. 171; *New York Iron Mine v. First Nat. Bk.*, 39 Mich. 644; see *Benedict v. Lansing*, 5 Denio, 283.

² *Stow v. Wyse*, 7 Conn. 214.

³ *Standifer v. Swann*, 7 Ala. 88.

⁴ *Blood v. Marcuse*, 38 Cal. 590.

Authority in a secretary to renew notes does not impliedly authorize him in renewing a note made by two persons to release one of them. *Moshannon Land Co. v. Sloan*, 109 Pa. St. 532.

⁵ *First Nat. Bk. v. Hogan*, 47 Mo. 472. Nor has a secretary authority to sign a due-bill. *Gregory v. Lamb*, 16 Neb. 205. Compare, generally, *Fay*

v. Noble, 12 Cush. 1; *Richmond Enquirer Co. v. Robinson*, 24 Gratt. (Va.) 548. As to a treasurer's authority, § 193, note.

⁶ *State v. Citizens' Savings Bk.*, 31 La. Ann. 836.

⁷ *Stokes v. New Jersey Pottery Co.*, 46 N. J. L. 237.

⁸ See *Spangler v. Butterfield*, 6 Col. 356, 363.

⁹ *Chemical Nat. Bk. v. Kohner*, 85 N. Y. 189.

¹⁰ *Western Bank v. Gilstrap*, 45 Mo. 419; *Southgate v. Atlantic and Pac. R. R. Co.*, 61 Mo. 89; *Frost v. Domestic Sewing Machine Co.*, 133 Mass.

general managing agent, in whose charge were placed the affairs of a corporation, might, without authority from the directors, assign choses in action belonging to the corporation in payment of its debt.¹ A mining superintendent, however, is held to have no implied authority to borrow money;² nor has the treasurer of a savings bank;³ though it has been decided to be within the powers of a president of a mill company, who was also its superintendent and general agent, to execute for the company its promissory notes, for money paid by one of its directors to satisfy a debt due from the corporation to a creditor who was threatening suit.⁴

§ 203. A corporate agent sometimes makes a contract which is apparently within his authority, yet which, taken in connection either with the existence or non-existence of some fact extrinsic to the contract, or with the intention of the agent, is beyond his authority, and perhaps *ultra vires* the corporation. If the impropriety of the contract consists in the unexpressed intention of the corporate representative, and the other contracting party acts in good faith, having no cause to suspect any such improper intention, the contract will be binding on the corporation.⁵ As

Validity of agent's act when not affected by extrinsic facts.

563. See *Holmes v. Board of Trade*, 81 Mo. 137. But subordinate officers and agents have not implied authority to employ counsel. *Maupin v. Virginia Lead M'fg Co.*, 78 Mo. 24.

¹ *McKiernan v. Lenzen*, 56 Cal. 61.

² *Union Gold Mining Co. v. Rocky Mt. Nat. Bk.*, 2 Col. 565; compare *Same v. Same*, 1 Col. 531; *Consolidated Gregory Co. v. Raber*, 1 Col. 511. A railroad superintendent has power to conduct ordinary business transactions, *e. g.*, accept cord-wood. *Sacalaris v. Eureka, etc. R. R. Co.*, 18 Nev. 155.

³ *Fifth Ward Savings Bank v. First Nat. Bank*, 48 N. J. L. 513.

⁴ *Seeley v. San José Mill Co.*, 59 Cal. 22. As in this case, the act of the president was ratified both by the

directors and at a shareholders' meeting, the court need not have decided it to have been within the power of the president. The powers of directors, presidents, and cashiers are particularly discussed below.

⁵ Even though the contract viewed in connection with the purposes of the agent was *ultra vires* the corporation; thus, if a contract to guaranty the bonds of another railroad company is on its face such as a certain railroad company has power to make, the fact that the guaranty was made for an unauthorized purpose, *e. g.*, the accommodation of the other road, will not affect the right of a *bona fide* holder of the bonds without notice, to recover on the guaranty. *Madison and Indianapolis R. R. Co. v. Norwich S'v'gs Society*,

far as concerns the other contracting party, the contract is within the agent's authority; and if the agent intends something further and unauthorized, that intention, if carried out, is a violation of duty towards a principal with which the other contracting party is not connected, for a person dealing in good faith with an agent, who is apparently acting within the scope of his authority, is not responsible for any breach of trust the agent may intend or perpetrate in regard to his own principal. As between the other contracting party and the corporation, the rule applies that where one of two innocent parties must suffer from the unauthorized act of an agent, the loss should fall on him who selected the agent, and whom the agent represents. It is certainly not the business of persons dealing with agents to be on the watch lest the agents wrong their principals. Thus, in a case where the plaintiff delivered certain moneys to the president, who was the general manager of the defendant corporation and had often borrowed money for it before, the court held that, in the absence of anything to show bad faith on the part of the plaintiff, the corporation could not defend by showing that the moneys had not been used in the corporate business.¹

§ 204. The maxim *Omnia præsumuntur rite esse acta* applies to acts done on behalf of corporations; and it can never be presumed that a corporate agent is acting wrongfully;² or that an act which might have been

Presump-
tions in
favor of the

24 Ind. 457. See also *Farmers and Mechanics' Bk. v. Butchers and Drivers' Bk.*, 16 N. Y. 125. See §§ 284-286.

¹ *Kraft v. Freeman Printing Ass'n*, 87 N. Y. 628; acc. *Thompson v. Lambert*, 44 Iowa, 239.

² "When the common seal of a corporation appears to be affixed to an instrument, and the signatures of the proper officers are proved, the courts are to presume that the officers did not exceed their authority, and the seal itself is *prima facie* evidence that it was affixed by proper authority." *Angell and Ames on Corp.*, § 224;

Trustees of Canandaigua Academy v. McKechnie, 90 N. Y. 618; *Solomon's Lodge v. Montmollin*, 58 Ga. 547; *Wood v. Whelen*, 93 Ill. 153; *Lovett v. Steam Saw Mill Ass'n*, 6 Paige's Ch. 54; *Flint v. Clinton Company*, 12 N. H. 430; *Evans v. Lee*, 11 Nev. 194; *Chouquette v. Barada*, 28 Mo. 491; *Mickey v. Stratton*, 5 Sawyer, 475; *Bliss v. Kaweah Co.*, 65 Cal. 502; see *New England Iron Co. v. Gilbert, etc. R. R. Co.*, 91 N. Y. 153. Compare *Osborne v. Tunis*, 25 N. J. L. 633; *Bank of the United States v. Dandridge*, 12 Wheat. 64, 70; *Hilliard v. Gould*, 34 N. H. 230, 239;

validity of
the acts of
corporate
agents.

a proper act to do on behalf of the corporation, was done under circumstances rendering it improper.¹

Accordingly, if under circumstances which a party dealing with a corporate agent has no reason to suppose not to exist, the corporate agent has authority to make the contract or do the act in question, the party dealing with him is justified in assuming the existence of the circumstances, and, acting in good faith on such assumption, will be protected.² As Justice Swayne said, giving the opinion of the Federal Supreme Court in *Merchants' Bank v. State Bank*:³ "Where a party deals with a corporation in good faith,—the transaction is not *ultra vires*—and he is unaware of any defect of authority or other irregularity on the part of those acting for the corporation, and there is nothing to excite suspicion of such defect or irregularity, the corporation is bound by the contract, although such defect or irregularity in fact exists. If the contract can be valid under any circumstances, an innocent party in such a case has a right to presume their existence and the corporation is estopped to deny them."⁴

§ 205. Accordingly, when the agent of a corporation has power to make negotiable paper on its behalf, a party receiving

Maas v. Missouri K. and T. R'y Co., 83 N. Y. 223; *C. B. & Q. R. Co. v. Lewis*, 53 Iowa, 101; *Atlantic and P. R. R. Co. v. St. Louis*, 66 Mo. 228; *Goodnow v. Oakley*, 68 Iowa, 25; *Morse v. Beale*, 68 Iowa, 463.

¹ *Chatauqua County Bank v. Risley*, 19 N. Y. 369, 381; *Yates v. Van De Bogert*, 56 N. Y. 526; *Olcott v. Tioga R. R. Co.*, 27 N. Y. 546; *DeGross v. American Linen Thread Co.*, 21 N. Y. 124; *Farmers' Loan and Trust Co. v. Perry*, 3 Sandf. Ch. 339; *Same v. Clowes*, 3 N. Y. 470; *Same v. Curtis*, 7 N. Y. 466; *New York Firemen Ins. Co. v. Sturges*, 2 Cow. 664; *Ex parte Peru Iron Co.*, 7 Cow. 540; *Blake v. Holley*, 14 Ind. 383; *Dockery v. Miller*, 9 Humph. (Tenn.) 731; *Mitchell*

v. Rome R. R. Co., 17 Ga. 574; *Morris and Essex R. R. Co. v. Sussex R. Co.*, 20 N. J. Eq. 542; *Oxford Iron Co. v. Spradley*, 46 Ala. 98; *Hart v. Missouri State Ins. Co.*, 21 Mo. 91.

² *Bank of Batavia v. N. Y. etc. R. Co.*, 106 N. Y. 195; *Steamboat Co. v. McCutcheon*, 13 Pa. St. 13; *Royal British Bk. v. Turquand*, 6 El. & Bl. 327; *Eastern Counties R'y v. Hawkes*, 5 H. L. C. 331. See *Moss v. Rossie Lead M'g Co.*, 5 Hill, 137, and cases in following notes.

³ 10 Wall., 604, 644.

⁴ See also *Gano v. Chicago, etc. Ry. Co.*, 60 Wis. 12; *Schallard v. Eel River Navigation Co.*, 70 Cal. 144.

such paper in good faith may assume that it was issued by the agent for an authorized purpose in the ordinary course of the business of the corporation.¹ So, if an agent has authority to borrow for his corporation moneys not exceeding a certain amount, the corporation will be liable to a person lending money to the agent in ignorance that the amount limited had already been borrowed.²

Negotiable paper. Money borrowed in excess of statutory limit.

§ 206. The circumstances, however, the existence of which an outsider is protected in assuming, must be such as he has no ground to suppose not to exist; they must not be extraordinary and unusual. Thus, an outsider is not justified in assuming that the cashier of a bank has authority to bind it as an accommodation indorser on his own individual note.³ Nor is an outsider justified in assuming authority in corporate officers to issue negotiable paper in the name of the corporation, when the issuance of such a paper is altogether foreign to the purposes for which the corporation was organized.⁴

Assumption of unusual facts unwarranted.

¹ Monument Nat. Bk. v. Globe Works, 101 Mass. 57; Commercial Bank v. St. Croix M'f'g Co., 23 Me. 280; Lafayette Bank v. St. Louis Stoneware Co., 2 Mo. App. 299; Madison and Indianapolis R. R. Co. v. Norwich Saving Society, 24 Ind. 457; Ridgeway v. Farmers' Bank, 12 S. & R. 256; Philadelphia, etc. R. R. Co. v. Lewis, 33 Pa. St. 33; McIntire v. Preston, 10 Ill. 48; Stoney v. American Ins. Co., 11 Paige, 635; Mechanics' Banking Ass'n v. White Lead Co., 35 N. Y. 505; *Ex parte* Estabrook, 2 Lowell, 547; National Bank v. Young, 41 N. J. Eq. 531; Credit Co. v. Home Machine Co., 54 Conn. 357. Compare McCullough v. Moss, 5 Denio, 567. See §§ 204, 284-286, 329-332.

² Ossipee M'f'g Co. v. Canney, 54 N. H. 295; see Gordon v. Sea Fire Life Assurance Soc'y, 1 H. & N. 599. In Garret v. Burlington Plow Co., 70

Iowa, 697, it was held that money loaned by directors to a corporation in excess of the statutory limit on the capacity of the corporation to borrow could be recovered, although the directors knew that the limit was exceeded.

³ West St. Louis Savings Bank v. Shawnee County Bank, 95 U. S. 557. See § 241. It cannot be presumed that directors have authority to sell property of a corporation essential to its business. Rollins v. Clay, 33 Me. 132.

⁴ Bacon v. Mississippi Ins. Co., 31 Miss. 116. See § 329. An officer of a corporation has no authority to give its notes to take up the outstanding obligations of shareholders; and such notes will not bind the corporation, in the hands of a person having knowledge of the facts. McLellan v. Detroit File Works, 56 Mich. 579.

Certification by agent of facts on which his authority is conditioned.

§ 207. If from the mere doing of the act by the corporate agent on behalf of the corporation, the person dealing with him is entitled to infer the existence of circumstances on which the agent's authority depends, then the case becomes stronger in favor of such person when the agent expressly affirms the existence of the circumstances in question. Here the person dealing with him has an express assertion to rely on, and not merely the implication arising from the presumption that the agent is not acting wrongfully. Accordingly if it is within the power of the corporate agent to certify to the existence of any fact, *e. g.*, the circumstances on which his authority to act depends, and he does certify to its existence, his certification will bind the corporation as towards persons who have acted thereon in good faith; and the corporation cannot plead the fraud of its own agent acting within the scope of his authority.¹

§ 208. Further, the general proposition is submitted, that it is within the authority of a corporate agent to certify to the existence of any fact not unusual or extraordinary in itself, nor rendered improbable from special circumstances known to the person dealing with him, which is peculiarly within his knowledge and on which his authority to act in that particular case depends; provided to act in such cases be within the ordinary scope of the agent's powers. As Judge Davis said, giving the opinion of the New York Court of Appeals in *New York and New Haven R. R. Co. v. Schuyler*,² "Where the principal has clothed his agent with power to do an act upon the existence of some extrinsic fact necessarily and peculiarly within the knowledge of the agent, and of the existence of which the act of executing the power is itself a representation, a third person dealing with such agent in entire good faith pursuant to the apparent power may rely on the representation, and the principal is estopped from denying its truth to his prejudice." And again, as stated by Judge Selden in *Griswold v. Haven*,³ and approvingly cited by Judge Davis in the opinion last re-

¹ *Whiting v. Wellington*, 10 Fed. Rep. 810.

² 34 N. Y., 30, 73. Acc. *Willis v. Fry*, 13 Phila. 33.

³ 25 N. Y., 595, 602.

ferred to:¹ "When the authority of an agent depends upon some fact outside the terms of his power, and which, from its nature, rests particularly within his knowledge, the principal is bound by the representation of the agent, although false, as to the existence of such fact."²

§ 209. If, however, the person contracting with the corporate agent has notice of any intended violation of his duty on the part of the agent, or of the existence of circumstances negating his authority to act, the corporation will not be bound; for such a person, far from acting in good faith, has been privy to a breach of trust. And evidently no estoppel can exist in his favor, because he cannot have relied on representations, express or implied, known to him to be untrue. Thus, a corporation is not liable for money borrowed by its directors in its name, when the corporation has not received the consideration, and the lender knew that the money was to be applied to the individual purposes of the officers.³ And, since the officers of a corporation have no power to execute its note to secure a debt bearing no relation to the corporate business, due from a third person to the payee of the note, neither the payee nor any other person with knowledge of the circumstances under which the note was insured, can recover on it against the corporation.⁴

Not binding on the corporation when the other party knows its falsity.

§ 210. Just as agents of natural persons, the agents of a corporation in contracting or otherwise acting on its behalf, have incidental authority to make admissions or declarations, which within the scope of the agent's ordinary employment, or of the authority specially conferred on him for the matter in hand, will bind the corporation or be evidence against it, according to the nature of the admission.⁵ Likewise, notice to directors or other corporate

Admissions of corporate agents. Notice to them.

¹ 34 N. Y., pp. 68 and 73.

² See also *Farmers and Mechanics' Bk. v. Butchers and Drovers' Bk.*, 16 N. Y. 125, 142.

³ *Culver v. Reno Real Estate Co.*, 91 Pa. St. 367.

⁴ *Hall v. Auburn Turnpike Co.*, 27 Cal. 255. See also *Ehrgott v. Bridge*

Manufactory; 16 Kan. 486; *Rahm v. Same*, 16 Kan. 277.

⁵ *Xenia Bank v. Stewart*, 114 U. S. 224; *Northrup v. Mississippi Valley Ins. Co.*, 47 Mo. 435; *Western Boatmen's Benevolent Ass'n v. Kribben*, 48 Mo. 37; *Toll Bridge Co. v. Betsworth*, 30 Conn. 380; *Morris and*

agents, or knowledge on their part, regarding matters within the scope of their authority or the range of their ordinary occupations, received or possessed while transacting corporate business, will be the knowledge of or notice to the corporation.¹ But, on the other hand, the admissions or statements of corporate agents regarding matters beyond their authority to act for the corporation,² or matters in which they are not acting on

Essex R. R. Co. v. Green, 15 N. J. Eq. 469; *Malecek v. Tower Grove*, etc. Ry. Co., 57 Mo. 17; *Hoag v. Lamont*, 60 N. Y. 96; *Webb v. Smith*, 6 Col. 365; *Merchants' Despatch Trans. Co. v. Léysor*, 89 Ill. 43; *Huntington, etc. R. R. Co. v. Decker*, 82 Pa. St. 119. For instance, declarations of a freight agent made in performance of his duty are evidence against a railroad company. *Lane v. Boston & A. R. R. Co.*, 112 Mass. 455. Declarations of brakemen, engineers, conductors, etc., to be admissible against the corporation must be made at the time of the occurrence so as to constitute part of the *res gestæ*. *Vicksburg & M. R. R. Co. v. O'Brien*, 119 U. S. 99; *Michigan Central R. R. Co. v. Coleman*, 28 Mich. 440; *Hannibal & St. Jo. R. R. Co. v. Martin*, 11 Ill. App. 386; *Dietrich v. Baltimore, etc. Ry. Co.*, 58 Md. 347; *Michigan Central R. R. Co. v. Carrow*, 73 Ill. 348; *Pittsburgh C. & St. L. R. R. Co. v. Theobald*, 51 Ind. 246. Compare *McLeod v. Ginther*, 80 Ky. 399; *O'Connor v. Chicago, etc. Ry. Co.*, 27 Minn. 166. The acts of an agent within his powers may estop a corporation as they would an individual principal. *Railroad Co. v. Schutte*, 103 U. S. 118; *Little Rock & N. R. R. Co. v. Little Rock, etc. R. R. Co.*, 36 Ark. 663.

¹ *Keith v. Globe Ins. Co.*, 52 Ill. 518; *Pont-Chartrain R. R. Co. v.*

Heirn, 2 La. Ann. 129; *Pittsburgh, etc. R. R. Co. v. Ruby*, 38 Ind. 294; *Egerton v. Fulton Nat. Bk.*, 43 How. Pr. (N. Y.) 216; *Ex parte Stewart*, 11 Jur. N. S. 25; *Lovell v. St. Louis Mutual Life Ins. Co.*, 111 U. S. 264; *New York & N. E. R. R. Co. v. New York, etc. R. R. Co.*, 52 Conn. 274, 280; *Cragie v. Hadley*, 99 N. Y. 131; *Loring v. Brodie*, 134 Mass. 453. Notice of the dangerous condition of the mines to the superintendent is notice to the mining company. *Quincy Coal Co. v. Hood*, 77 Ill. 68. Knowledge of the president of a bank received or possessed while discounting a note on its behalf, is the knowledge of the bank; and his accidental absence at any particular time is no legal excuse to the bank for its failure to act on such knowledge. *Central Nat. Bank v. Levin*, 6 Mo. App. 543. Notice to a board of directors is notice to the bank, and no subsequent change of directors can require a new notice. *Mechanics' Bk. v. Seton*, 1 Pet. 299. If notice is given to a director officially, to the end that it may be communicated to the board, the corporation is affected with notice, although the director does not communicate it to the board. *Boyd v. Chesapeake and Ohio Canal Co.*, 17 Md. 195. Compare *Nat. Security Bk. v. Cushman*, 121 Mass. 490, and the cases in the following notes.

² *Bishop v. Globe Co.*, 135 Mass. 132; *Commonwealth v. Reading Sav-*

its behalf are not evidence against it;¹ nor is a corporation affected with notice to a corporate agent or with his knowledge acquired under such circumstances.² Accordingly, when an officer of a corporation sells it his own property, he does not represent the corporation in the transaction so as to affect it with knowledge which he possesses, but does not communicate, of facts derogatory to his title to the property.³ And the fact that the cashier of a bank was a director in another corporation, which was the payee and indorser of a note, will not affect the bank with notice of equities subsisting between the maker and the payee.⁴ Nor will knowledge by one of several corporators of the existence of an incumbrance on property purchased by

ings Bank, 137 Mass. 431, 444; Tripp v. New Metallic Packing Co., 137 Mass. 499; Johnston v. Elizabeth Building Ass'n, 104 Pa. St. 394. That an individual is a director, and a member of the discount board of a bank will not, in the absence of special authority to act as its agent in a particular transaction regarding the renewal of a note, authorize him to make admissions or statements concerning such transaction, which will be binding on the corporation. East River Bk. v. Hoyt, 41 Barb. 441. The treasurer of a manufacturing company has no authority *virtute officii* to bind it by written admissions as to the amount due on a disputed claim for salary of the superintendent. Kalamazoo Novelty M'fg Co. v. McAlister, 36 Mich. 327; see Henry v. Northern Bk., 63 Ala. 527. Nor to confess judgment on behalf of his corporation. Stevens v. Carp River Iron Co., 57 Mich. 417.

¹ Declarations or statements of individual directors, made when the board is not in session and not accompanying any official act, are not competent evidence against the corporation. Peek v. Detroit Novelty Works, 29 Mich. 313.

² Bank of United States v. Davis, 2 Hill (N. Y.), 451; Platt v. Birmingham Axle Co., 41 Conn. 255; Savannah Bank v. Hartridge, 73 Ga. 223; Fairfield Savings Bank v. Chase, 72 Me. 226; Shaw v. Clark, 49 Mich. 384; Farrel Foundry v. Dart, 26 Conn. 376; Mercier v. Canonge, 8 La. Ann. 37; United States Ins. Co. v. Shriver, 3 Md. Ch. 381; Wells v. American Exp. Co., 44 Wis. 342; Winchester v. Baltimore & S. R. Co., 4 Md. 231. Compare Hoffman Steam Coal Co. v. Cumberland Coal Co., 16 Md. 456; Smith v. South Royalton Bk., 32 Vt. 341; Terrell v. Branch Bank, 12 Ala. 502; Whelan v. McCreary, 64 Ala. 319.

³ Barnes v. Trenton Gas Light Co., 27 N. J. Eq. 33; Peckham v. Hendren, 76 Ind. 47; Wickersham v. Chicago Zinc Co., 18 Kan. 481; Davis Improved Wrought Iron Wagon Wheel Co. v. Davis, etc. Co., 22 Blatchf. 221. Compare Tarbox v. Gorman, 31 Minn. 60. Compare Mihill's M'fg Co. v. Camp, 49 Wis. 130.

⁴ First Nat. Bk. v. Loyhed, 28 Minn. 396. See § 641.

the corporation, affect his associates when he does not act as their agent in forming the company.¹

§ 211. If an unauthorized act is done on behalf of a corporation, although the corporation may not be bound by the act as done, yet, if the corporation or that corporate authority which would have been competent originally to do the act, knowingly ratifies it or accepts the benefit of it, or if all the persons having a right to object to the act knowingly acquiesce in it, the act will be as binding on the corporation as if it had been originally authorized.² This proposition is but an application of the doctrine of the law of agency, that when a person ratifies the unauthorized act of another who has purported to act on his behalf, the legal effect of the act will be the same as if it had been authorized before it was done. True, in applying this doctrine to corporations, circumstances and the complicated legal relations subsisting in respect of corporate enterprises must be taken into consideration. Nevertheless, the doctrine applies to corporations in its fullest scope,³ and with them, as with natural principals, subsequent ratification is equivalent to antecedent authority.⁴ The important principle to be borne in mind is this: the ratification to be binding on the corporation must be the act or acquiescence of some corporate agency which itself would have had the power to do or authorize the unauthorized acts; for a ratification cannot arise from the action either of the officers

¹ *Burt v. Batavia Paper M'fg Co.*, 86 Ill. 66. So, on the other hand, when a person is merely in possession of bank stock as collateral security, does not participate in shareholders' meetings, and is not recognized by shareholders as a member, he is not such a member of the corporation as to be bound to have knowledge of facts known to the corporation or its officers. *Baker v. Woolston*, 27 Kan. 185.

² The effect of acquiescence in *ultra vires* acts, by persons entitled to object, is discussed in Part III. of the

present chapter. The discussion here relates only to acts within the scope of the corporate powers.

³ *Kelsey v. National Bank*, 69 Pa. St. 426.

⁴ *First Nat. Bank v. Fricke*, 75 Mo. 178; *Planters' Bank v. Sharp*, 12 Miss. 75. *Mt. Washington Hotel Co. v. Marsh*, 63 N. H. 230; *Greenleaf v. Norfolk Southern R. R. Co.*, 91 N. C. 33.

The maxim *Omnis rati habitio retro trahitur et mandato priori æquiparatur* applies. *Fleckner v. Bank of the U. S.*, 8 Wheat. 338, 363.

who did the unauthorized acts¹ or of those who would have had no authority to do them.² But unquestionably a valid ratification can take place through the action of superior corporate agents, for instance directors, who could competently have done the act themselves or authorized it to be done.³ And the body corporate, in a duly summoned meeting, may ratify any act of the directors which it was competent for the body corporate acting as such to perform.⁴

§ 212. A formal ratification is not requisite. If there is no express ratification by the action either of the body corporate, or of superior agents having authority, whether or not an act has been ratified is a question of fact for the jury. And, in general, it may be said, that whether the alleged ratification be that of the body corporate or of superior corporate agents, it may be proved by continued acquiescence on the part of the persons competent to ratify, when knowledge of the facts may be shown, reasonably inferred, or presumed to have been had by the persons acquiescing.⁵

Formal
ratification
not neces-
sary.

Thus, if the president of a manufacturing company, in excess of his authority, executes a mortgage, the mortgage will be binding on the company if the directors who could competently have authorized it knowingly acquiesce for a considerable

¹ *Tracy v. Guthrie County Agricultural Society*, 47 Iowa, 27.

² Even directors cannot ratify the act of the president, which they themselves had no authority to perform. *Crum's Appeal*, 66 Pa. St. 474.

³ *Scott v. Middletown, etc. R. R. Co.*, 86 N. Y. 200; *Fleckner v. Bank of U. S.*, 8 Wheat. 338, 363; *Sherman v. Fitch*, 98 Mass. 59; *Lyndeborough Glass Co. v. Massachusetts Glass Co.*, 111 Mass. 315; *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439.

⁴ For example, if it is within the power of the body corporate to issue further stock, but not within the power of the directors, an unauthorized issue

made by the directors may be ratified by a vote of the body corporate. *In re New Zealand Banking Co.*, *Sewell's Case*, L. R. 3 Ch. 131; *In re British Provident, etc. Assurance Society*, *Lane's Case*, 1 DeG. J. & S. 504; see *Payson v. Stoevers*, 2 Dill. 427, § 213.

⁵ *Indianapolis Rolling Mill v. St. Louis, etc. R. R. Co.*, 120 U. S. 256. To constitute a valid ratification, the principal must have had at the time of the ratification full knowledge of the circumstances attending the performance of the unauthorized act. *Benninghoff v. Agricultural Ins. Co.*, 93 N. Y. 495. See §§ 214, 215, 216.

time.¹ So, in another case where a master mechanic on a railroad without authority employed a physician to attend an injured employé, and sent the physician's bill in a letter to the division superintendent, who would have had authority to employ the physician, it was held that a jury might find a ratification on the part of the superintendent from his neglect to pay any attention to the bill and letter sent him.²

§ 213. In a similar manner the ratification on the part of the body corporate or shareholders may be proved. Thus, the capital stock of a company had been increased by the directors without authority. At a regular annual meeting, however, the matter was reported to the shareholders, who did not then object, and the holders of the shares improperly issued voted at the meeting as shareholders. These facts, it was held, amounted to a ratification.³ Again, the trustees of a manufacturing corporation in good faith conveyed all its property to settle a judgment debt which the corporation had no other means of paying. The value of the property conveyed did not exceed the amount of the judgment, and all the shareholders had notice of the conveyance about the time when it was made. The court held, that after the lapse of four years no action would lie either by the corporation or its shareholders to set aside the conveyance.⁴

§ 214. An implied ratification may also arise if the corporation accepts the benefit of the unauthorized act.⁵ But a cor-

¹ *Sherman v. Fitch*, 98 Mass. 59; *Lyndeborough Glass Co. v. Massachusetts Glass Co.*, 111 Mass. 315; *Lester v. Webb*, 1 Allen, 34; *Waltham County Bk. v. Farmers' Loan and Trust Co.*, 16 Wis. 629; *Darst v. Gale*, 83 Ill. 136; *Chicago Building Society v. Crowell*, 65 Ill. 453; *Perry v. Simpson Waterproof M'f'g Co.*, 37 Conn. 520; see *Texas and St. L. R. R. Co. v. Robards*, 59 Tex. 545; *Peterborough R. R. Co. v. Nashua and L. R. R. Co.*, 59 N. H. 385.

² *Pacific R. R. Co. v. Thomas*, 19

Kan. 256. See also *Lewis v. Albermarle, etc. R. R. Co.*, 95 N. C. 179.

³ *Payson v. Stoeve*, 2 Dill. 427; *Phosphate of Lime Co. v. Green, L. R.* 7 C. P. 43. Compare *Miller v. Rutland, etc. R. R. Co.*, 36 Vt. 452.

⁴ *Sheldon Hat Blocking Co. v. Eickmeyer Hat Blocking Machine Co.*, 90 N. Y. 607.

⁵ *Taylor v. Agricultural, etc. Ass'n*, 68 Ala. 229; *Bezan v. Pike*, 23 La. Ann. 788; *Medomak Bank v. Curtis*, 24 Me. 36; *Grape Sugar M'f'g Co. v. Small*, 40 Md. 395; *Wood Hydraulic M'f'g Co. v. King*, 45 Ga. 34.

poration will not be held to have ratified an act impliedly by accepting the benefit of it, unless knowledge of the act was actually possessed by some corporate agent who would have had authority to act for the corporation in the matter,¹ or whose function it was to report it to the proper authorities; or unless knowledge of the act would have been possessed by some such agent had there not been neglect of duty on his part, the consequences of which are to be borne by the corporation, rather than by the party from whose performance it has been benefited.²

Ratification through accepting benefit of unauthorized act. Knowledge or implied notice essential.

§ 215. Consequently, in order to constitute an implied ratification on the part of the corporation, arising from acquiescence or from accepting the benefit of an act, it may not be necessary that the circumstances should be such as to warrant a jury in finding actual knowledge on the part of the corporation or corporate agents competent to ratify. For the knowledge of one agent may, at least in the absence of proof to the contrary, be imputed to other agents who have authority to do the acts in question, or even to the corporation. Thus, where certain unauthorized loans were made by a person on behalf of a corporation with banking powers, who notified the cashier, it was held, although the cashier himself had no power to ratify the unauthorized acts, that notice to him was notice to the board of

¹ Gilman, etc. R. R. Co. v. Kelly, 77 Ill. 426; Murray v. Nelson Lumber Co., 143 Mass. 250.

Thus, where the president of a corporation executed an unauthorized lease of mining property, and the corporation accepted the rent, but as "money for ores sold," not knowing of the lease, it was held that there was no ratification. Yellow Jacket Silver M'g Co. v. Stevenson, 5 Nev. 224. See § 212, note.

² Where a railroad company receives railroad material bought without authority by the president on its credit and for its use, and the material is used for corporate purposes with the

assent of the directors, that is an adoption and ratification of the president's act; and the directors using the purchased material were bound to inquire and were presumed to know whether it was paid for or not: it is not essential to the adoption of the acts of an officer that the directors should know the terms of his contracts. Scott v. Middletown, etc. R. R. Co., 86 N. Y. 200. See Blen v. Bear River, etc. Water Co., 20 Cal. 602; Hazelhurst v. Savannah, etc. R. R. Co., 43 Ga. 13; Indianapolis Rolling Mill v. St. Louis, etc. R. R. Co., 120 U. S. 256. Compare Benninghoff v. Agricultural Ins. Co., 93 N. Y. 495, § 212, note.

directors, who had power to ratify; and accordingly a ratification was inferred through their neglect to repudiate; the court saying: "It was the duty of the managers at those meetings to inform themselves of the affairs of the company, and to take the same care of its funds and property as a prudent man would take of his own. The cashier was an officer selected and appointed by themselves, in whom they must be supposed to have entire confidence. An important part of his duty was to keep the managers informed of the state and condition of the company's funds, and to communicate to them everything affecting the interests of the company. Without presuming a gross neglect of duty on the part of the managers in meeting and making the inquiries in relation to the funds in New York, and a like neglect of duty on the part of their cashier in giving them information, it cannot be supposed that the managers remained ignorant of the loan now in controversy; or of the entire disposition which had been made of their funds in the defendants' bank during the month of June. The plaintiffs themselves cannot call on a court or jury to presume such a neglect on their part."¹

§ 216. Likewise notice to an agent who himself has no authority to ratify, may be notice to the corporation: and if within a reasonable time after such actual and implied notices there is no repudiation, an implied ratification from acquiescence may be presumed. Thus, in *Gold Mining Co. v. National Bank*,² a person acting as the agent of the company borrowed money on its account. The president accepted the accounts of the agents, thus acquiring actual knowledge of the transaction; and the court said that the president "was the suitable man to receive the information." Accordingly, the company failing to disavow the loan made to its agent within a reasonable time after its president had received information in the matter, was held to have assented to the acts of its agent as originally done in its name.³

¹ *New Hope, etc. Bridge Co. v. Phœnix Bank*, 3 N. Y. 156, 164; see *Chicago, etc. Ry. Co. v. James*, 24 Wis. 388; *Martin v. Webb*, 110 U. S. 7.

² 96 U. S. 640.

³ See also *Bennett v. Maryland Fire Ins. Co.*, 14 Blatchf. 422; *Hilliard v. Goold*, 34 N. H. 230. What directors ought by proper diligence to have

§ 217. Mere lapse of time does not in itself constitute a ratification; though in connection with the circumstances of the case lapse of time may be competent evidence of a ratification arising from acquiescence.¹ And when the corporation has had the full benefit of the unauthorized acts of its agents, from very slight evidence a ratification may be inferred,² as may be inferred from slight evidence the ratification of an act plainly beneficial to the corporation, like the acceptance of a grant.³

Lapse of time no ratification.

§ 218. The rules governing the powers of corporate agents in general to act for their corporations having now been discussed, as well as the legal effect of their acts as between the corporation and persons with whom they contract, it remains to consider more specifically the authority of certain prominent classes of corporate agents. And first of all as to the authority of the board of directors.

Authority of special classes of corporate agents.

§ 219. As a usual thing, the entire management of the business of a corporation is by its constitution vested in the board of directors; so that from the beginning the shareholders have little to do with the corporate management, their main function being to elect the directors. It may be, however, that according to the original organization of the company, the corporate powers are left to a large extent in the hands of the shareholders, to be exercised by themselves if they see fit. Under such circumstances the shareholders by resolution or by-law may delegate authority to the directors; and may at will revoke it, provided thereby no vested rights are affected. This latter style of organization is infrequent, and usually the powers of the directors emanate directly from the constitution of the corporation. Accordingly,

Powers of the board of directors.

known as to the general course of business of their corporation, they may be presumed to have known in any contract between the corporation and those who are justified by the circumstances in dealing with its officers upon the basis of that course of business. *Martin v. Webb*, 110 U. S. 7; see § 240.

See also *Merchants' Union Barb Wire Co. v. Rice*, 70 Iowa, 14.

¹ See *Evans v. Smallcombe*, L. R. 3 H. L. 249, 253, 260. See also especially § 269 *et seq.*

² See generally cases in the preceding notes; also §§ 279, 280.

³ *Bank of U. S. v. Dandridge*, 12 Wheat. 64, 70.

whether or not any given act is within the scope of their authority, is, in most instances, to be ascertained by a construction of the charter, or enabling acts and articles of association, including any statutes that may be applicable.

The common phrase is something like this: "the business of the corporation shall be managed by the board of directors;" or "the powers of the corporation shall be exercised by the board of directors." In consequence, the directors for ordinary purposes have full authority to act for the corporation and represent it in all matters pertinent to the corporate enterprise.¹

§ 220. The first and most general rule as to the extent of the power conferred by "authority to manage the business of the corporation," is that such power extends to the doing of any ordinary act conducive to the success or required by the exigencies of the business; and, since any person vested with authority to act for another must necessarily act largely according to an honest discretion, which under certain circumstances warrants acts that under different circumstances would constitute a flagrant breach of trust, so it may be said, that in critical emergencies the discretionary authority of directors justifies the doing of many acts which would be unauthorized under ordinary circumstances.

§ 221. The next general rule regarding the construction of the authority of directors is a negative one. Authority to manage the affairs of a corporation does not authorize the directors to change the scheme of the corporate enterprise or the nature of the corporate business; nor does it authorize them to bring the business to a conclusion either directly, or indirectly through acts which render the further carrying on of it as planned impossible.

¹ See *Hoyt v. Thompson's Ex'r*, 19 N. Y. 207, 216; *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163, 166; *Wood v. Whelen*, 93 Ill. 153; *Sims v. Street Railroad Co.*, 37 Ohio St. 556; *Maynard v. Firemen's Fund Ins. Co.*, 34 Cal. 48; *Wright v. Oroville M'g Co.*, Cal. 20; *Dana v. Bank of U. S.*, 5 W. & S. 246; *Bank of U. S. v. Dandridge*, 12 Wheat. 113 (per Marshall, C. J.); *Tripp v. Swanzev Paper Co.*, 13 Pick. 291; *Leavitt v. Oxford, etc. M. Co.*, 3 Utah, 265. When the directors and shareholders of a corporation are not identical, it is incompetent for the directors to bind the corporation by an agreement with a certain person that he shall be a director *Seymour v. Detroit Rolling Mills*, 56 Mich. 117.

§ 222. Thirdly and finally, since the constitution and all authority thereby conferred, relate to a specific enterprise and corporate purpose, no authority is conferred on directors to bind the corporation in regard to matters having no connection with the objects of incorporation.

Statement
of second
general
limitation.

The three preceding rules outline the law regulating the power of directors to bind by their acts the corporation and its property ; and the cases and instances now to be referred to will be but illustrations of their application, but of their application as affected by rules previously discussed in regard to presumptions and estoppels, and by special provisions in the constitution or by-laws of the corporation.

§ 223. How is the scope of the first general rule determined,—that directors may do any regular or ordinary act within the corporate powers, in the management of the corporate business? The word “ordinary” here is by no means synonymous with “routine ;” it is in no sense limited to daily clerical or ministerial management. It has a far more comprehensive meaning ; and a transaction may still be “ordinary” although of great importance, involving a large amount of money. In construing the term “ordinary business,” which a by-law empowered a quorum composed of less than a majority of directors to transact, Judge Comstock said, giving the opinion of the New York Court of Appeals in *Hoyt v. Thompson’s Executor*:¹ “The ordinary business of the corporation had, I think, no limit short of the varied and extensive affairs in which it was authorized by its charter to engage. It could construct and operate a canal, deal in stocks and in trusts, and it could carry on the business of banking in all its departments. If the due execution of these powers did not constitute the ordinary business of the company, then it seems to me impossible to suggest any definition of the term, and the by-law becomes senseless and unmeaning : and if these express powers of the corporation were embraced in the terms of the by-law, it must necessarily follow that the quorum designated took all the incidental

Scope of
the gen-
eral rule.

¹ 19 N. Y., 206, 217.

authority which the whole board would possess in the execution of the same powers. In the operation of banking, which constituted one portion of the ordinary business, it might become necessary to borrow money, and the power to do so existed. As debts could be contracted, the incidental power of paying them cannot be doubted. So, the condition of the company's affairs might require a negotiation with creditors, and the postponement and securing of their demands. To secure a debt, and procure its forbearance in a period of embarrassment, would not by any means be an extraordinary act, in the sense of the by-law, although it might be unusual in the magnitude and importance of the transaction."¹

§ 224. Accordingly, all business relating to the legitimate objects of incorporation, not involving a departure from the original plan, may be transacted by the directors.² They have full power to manage the concerns of the company.³ Thus, bank directors have authority to make discounts, and fix the discount rate.⁴ And with directors rests the power to place unsubscribed stock.⁵ Directors of a railroad company may competently contract to transport freight for a fixed term at a certain rate;⁶ and it has been held to be within the discretionary power of the boards of two connecting roads to make an agreement for the division of earnings proportioned to the distance that each corporation carries the passengers or freight for which the money is paid.⁷ Again, in a case where the deed

¹ Compromises to avoid and reduce losses come within the general scope of the powers of a board of directors of a national bank, and are submitted to their discretion, except in so far as there may be restrictions in the charter and by-laws. Banks may do in this behalf whatever natural persons could do under like circumstances. *First Nat. B'k v. Nat. Exchange B'k*, 92 U. S. 122. See *Keyser v. Hitz*, 2 Mackey (Dist. of Col.), 513.

² *Wood v. Whelen*, 93 Ill. 153.

³ *Sims v. Street Railroad Co.*, 37 Ohio St. 556; see *Dana v. Bank of United States*, 5 W. & S. 223, 246;

Bank of Kentucky v. Schuylkill Bank, 1 Pars. Sel. Cas. (Penn.) 236; *Wright v. Oroville M'g Co.*, 40 Cal. 20; compare *Beaty v. Knowler's Lessee*, 4 Pet. 152; *Bargate v. Shortridge*, 5 H. L. Cas. 297.

⁴ *Bank of United States v. Dunn*, 6 Pet. 51; *Bank Commissioners v. Bank of Buffalo*, 6 Paige, 497.

⁵ *Sims v. Street Railroad*, 37 Ohio St. 556.

⁶ *Railroad Co. v. Furnace Co.*, 37 Ohio St. 321.

⁷ *Elkins v. Camden and Atlantic R. R. Co.*, 36 N. J. Eq. 241.

of settlement of a joint-stock bank gave its directors extensive powers to carry on the business of banking and to act in such manner as might appear to them best calculated to promote the interest of the bank, it was held that they had power to guaranty the payment of interest on debentures of another company issued for the purposes of its formation, when that was of importance to the bank.¹ Directors are the proper officers to institute legal proceedings on behalf of the corporation, and to that end have unquestioned authority to employ counsel,² and compromise litigation.³

§ 225. To carry on the corporate business, directors have power to borrow money for the corporation,⁴ and in the absence of express restriction on their power in this respect,⁵ may secure the corporate indebtedness by a pledge of its personal property or a mortgage of its real estate.⁶ Likewise directors may assign any choses in action or

Power
of directors
to borrow.

¹ *In re West of England Bank, Ex parte Booker*, L. R. 14 Ch. D. 317. So, where a lease was made of its road by one railroad corporation to another, which lease was executed by the shareholders and provided for a guaranty by the lessee corporation of a ten per cent. annual dividend on the stock of the lessor corporation, it was held that the respective boards of directors had power to modify the terms of the lease and reduce the amount guaranteed. *People v. Metropolitan Ry. Co.*, 26 Hun, 82; *Flagg v. Manhattan Ry. Co.*, 10 Fed. Rep. 413; S. C., 20 Blatchf. 142. (Quære as to the propriety of these two decisions, which may yet be reversed on appeal.) See *Sheffield Nickel Co. v. Unwin*, 36 L. T. N. S. 246; S. C., L. R. 2 Q. B. Div. 214.

² See *Pollok v. Shultze*, 1 Hun, 320.

³ *Donohue v. Mariposa Land, etc. Co.*, 66 Cal. 317. See § 223, note.

⁴ *Ridgway v. Farmers' Bk.* 12 S. & R. 256, and cases in following notes. But a single director has no such power

by virtue of being a director. *Lawrence v. Gebhard*, 41 Barb. 575.

⁵ See *Davis v. Flagstaff Silver M'g Co.*, 2 Utah, 74; compare *Flagstaff Silver M'g Co. v. Patrick*, ib. 304. See also chap. 40 of New York Laws of 1848 for an example of a restriction on the power of trustees (directors) to mortgage the corporate property. Capital not paid up is only *sub modo* property of the corporation; the due making of a call being a condition precedent to the absolute proprietary right of the company therein. Consequently, a power given to the directors to mortgage the property of a corporation does not authorize them to include in such mortgage future calls, i. e., the unpaid capital of the company. *Bank of South Australia v. Abrahams*, L. R. 6 P. C. 265.

⁶ *Wood v. Whelen*, 93 Ill. 153; *Burrill v. Nahant Bk.*, 2 Metc. (Mass.) 163; *Hendee v. Pinkerton*, 14 Allen, 381; see *Tripp v. Swanzy Paper Co.*, 13 Pick. 291; *Hopson v. Aetna Axle*,

transfer any property of the corporation,¹ provided the property transferred be not essential to the carrying out of the objects of incorporation.² And authorities hold that the directors of an insolvent corporation may assign all its property for the payment of its debts, when to make such an assignment is within the powers of the corporation.³ Thus, according to a Massachusetts case, directors of a corporation suddenly rendered insolvent by the burning of its works, have authority to convey to a creditor all the corporate property provisionally, upon condition to pay or provide for the payment of the just debts of the corporation to himself; he giving proper security to apply no more than necessary and pay over the remainder to the treasurer of the corporation for the benefit of other creditors.⁴

§ 226. Under the second general rule, that directors cannot change the scheme of the corporate enterprise nor bring the business to a conclusion, there are four things which directors cannot do.

First general limitation.

etc. Co., 50 Conn. 597. The executive committee of the board of directors, having been authorized by the board to procure a loan, and possessing according to the constitution of the corporation power to transact "any official business," may execute a mortgage. *Taylor v. Agricultural, etc. Ass'n*, 68 Ala. 229. Compare, as to authority of the directors of a railroad company to execute a mortgage of its property and franchises, *McCurdy's Appeal*, 65 Pa. St. 290, which seems to proceed on the assumption that they have such power, at least when the mortgage is not repudiated soon. Directors of a manufacturing company may mortgage practically all its property *to enable it to go on*. *Hopson v. Aetna Axle, etc. Co.*, 50 Conn. 597. See also *Arms v. Conant*, 36 Vt. 745, 748.

¹ *Marvine v. Hymers*, 12 N. Y. 223. But power to sell bonds is not in a single director *virtute officii*. *Titus v. Cairo and Fulton R. R. Co.*, 37 N. J.

L. 98. Compare *New Haven and Northampton Co. v. Hayden*, 107 Mass. 525.

² See § 229.

³ *Union Bank v. Ellicott*, 6 G. & J. 363; *Dana v. Bank of U. S.*, 5 W. & S. 223, 247; *Catlin v. Eagle Bk.*, 6 Conn. 233; *Gibson v. Goldthwaite*, 7 Ala. 281. See *Merrick v. Bank of the Metropolis*, 8 Gill, 59; *Sheldon Hat Blocking Co. v. Eickemeyer Hat Blocking Machine Co.*, 90 N. Y. 607; *Duncomb v. New York, H. and N. R. R. Co.*, 88 N. Y. 1; S. C., 84 N. Y. 190; *contra*, *Bank Commissioners v. Bank of Brest*, *Harrington's Ch. (Mich.)* 106. An assignment made, without the consent of shareholders, by the directors of a bank of all its assets is voidable at the suit of shareholders; but a creditor cannot object to the directors' lack of power. *Eppright v. Nickerson*, 78 Mo. 482. See § 230, note.

⁴ *Sargent v. Webster*, 13 Metc. (Mass.) 497.

§ 227. First, they cannot change the nature or plan of the corporate business, nor, in the absence of special authorization, can they accept from the legislature any substantial alteration or amendment in the corporate constitution.¹ But the rule denying the authority of directors to accept any legislation materially changing the constitution is not to be construed to preclude them from accepting the benefit of a statute which effects no changes, but which merely facilitates the exercise of franchises already conferred.²

¹ Baker's Appeal, 109 Pa. St. 461; Commonwealth v. Cullen, 13 Pa. St. 133; Brown v. Fairmount Gold M'g Co., 10 Phila. 32; Marlborough M'f'g Co. v. Smith, 2 Conn. 579; Hope Mut. Fire Ins. Co. v. Beckmann, 47 Mo. 93, 96; Mississippi, etc. R. R. Co. v. Gaster, 24 Ark. 96. See Verner v. Atchison, etc. R. Co., 28 Fed. Rep. 581. But see, *semble contra*, Dayton, etc. R. R. Co. v. Hatch, 1 Disney (Cin. Sup. Ct.), 86; Matter of Excelsior Fire Ins. Co., 16 Abb. Pr. (N. Y.) 8; Illinois River R. R. Co. v. Zimmer, 20 Ill. 654; Bahet v. Alton, etc. R. R. Co., 13 Ill. 504, 508. Compare Case of St. Mary's Church, 6 S. & R. 498; S. C., 7 S. & R. 517; Railway Co. v. Allerton, 18 Wall. 233, 235. In some of the cases in this note holding it beyond the power of directors to accept an amendment, the assent of *all* the shareholders might have been necessary. See § 532.

In the absence of express power in the deed of settlement, it is not competent for the directors to amalgamate with another company carrying on the same business, and assume on behalf of their own corporation the liabilities of the other company. A clause in the deed of settlement authorizing the directors "generally, where these pre-

sents are silent, or do not otherwise provide, to act in the direction of the concerns of the society in such manner as at their absolute discretion they shall think most conducive to the interests of the society" is not an authority for the purpose. *In re Era Assurance Society, Ex parte Williams*, 30 L. J. Eq. 137. See Blatchford v. Ross, 5 Abb. Pr. N. S. (N. Y.) 434. Directors of a railroad company have no authority to purchase the road of another company. *Deaderick v. Wilson*, 8 Bax. (Tenn.) 108.

² A statute was passed authorizing a railroad company to take for a passenger station land belonging to another railroad company. The by-laws provided that the directors might purchase what real estate they deemed necessary for the railroad, and exercise all powers granted to the company by the charter, for the purpose of locating, constructing, and completing the road, and all other powers necessary and proper to carry out the objects of the corporation: *Held* that an acceptance of the statute by shareholders was not necessary to authorize directors to take land in pursuance of it. *Eastern R. R. Co. v. Boston and Maine R. R. Co.*, 111 Mass. 125. See *Joy v. Jackson*, etc. Plank Road Co., 11 Mich. 155, 170.

§ 228. Secondly, directors have no power to increase or decrease the capital stock of the corporation.¹ In the leading case on this point, *Railway Company v. Allerton*, Justice Bradley said:² "A change so organic and fundamental as that of increasing the capital stock of a corporation beyond the limit fixed by the charter cannot be made by the directors alone, unless expressly authorized thereto. The general power to perform all corporate acts refers to the ordinary business transactions of the corporation, and does not extend to a reconstruction of the body itself, or to an enlargement of its capital stock."³

§ 229. Thirdly, directors cannot transfer property of the corporation which is essential to the continuance of the corporate business;⁴ nor have they power to give away the corporate funds or deprive the corporation of the means which it possesses to accomplish the purposes of its incorporation.⁵ Ac-

¹ When a corporation has the power to increase or diminish its capital stock, the mode of doing it and the conditions under which it may be done are usually prescribed by statute. But when the statute is silent the power rests in the body corporate, not in the board of directors. *Eidman v. Bowman*, 58 Ill. 444. On the general principle that the powers of a corporation not specially vested in any particular officers remain in the body corporate, see *Matter of Wheeler*, 2 Abb. Pr. N. S. (N. Y.) 361; *People v. Twaddell*, 18 Hun, 427, 432; *State v. Merchant*, 37 Ohio St. 251.

² 18 Wall., 233, 234.

³ *Gill v. Balis*, 72 Mo. 424; *Finley Shoe and Leather Co. v. Kurtz*, 34 Mich. 89; *Eidman v. Bowman*, 58 Ill. 444; *Percy v. Millaudon*, 3 La. 569. And directors cannot increase the capital stock indirectly, *e. g.*, by agreeing to pay in stock for services and for money loaned, when the corporation has no stock in its treasury. *Finley Shoe and Leather Co. v. Kurtz*, *supra*.

⁴ *Abbot v. American Hard Rubber Co.*, 33 Barb. 578; *Rollins v. Clay*, 33 Me. 132; *Balliet v. Brown*, 103 Pa. St. 546. Compare *Sheldon Hat Blocking Co. v. Eickemeyer Hat Blocking Machine Co.*, 90 N. Y. 607; *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439; and see § 225.

⁵ *Burke v. Smith*, 16 Wall. 390, 395; *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29, 37; *Jones v. Morrison*, 31 Minn. 140. See *Penobscot, etc. R. R. Co. v. Dunn*, 39 Me. 587, 601.

But it has been held that directors have power to apply £1500, out of the undivided profits of a manufacturing company, as a gratuity of one week's extra pay to each worker in the factory who had worked with a good character throughout the year. *Hampson v. Price's Patent Candle Co.*, 45 L. J. Eq. 437. The point came up on a motion by a shareholder to restrain the payment. But see *Jones v. Morrison*, 31 Minn. 140.

cordingly, directors cannot ordinarily lease the whole plant of a corporation;¹ nor can the directors of a railroad company lease its road without special authority.²

§ 230. Fourthly, if directors have no power to sell corporate property which is essential to the continuance of the business, *a fortiori* they have no power to wind up the affairs of the corporation.³

§ 231. The last of the three general rules above mentioned,⁴ is that directors have no authority to bind the corporation in matters not relating to the corporate business. On the face of it, this rule seems self-evident. All the powers of directors to represent the corporation, whether derived directly from the corporate constitution or conferred by a vote of the body corporate, have their ultimate bases in that constitution and in the agreement of the associates embodied in it. Consequently, directors have no power to do any act *ultra vires* the corporation;⁵ and, as the corporate constitution and the agreement embodied in it relate only to the corporate enterprise, any acts having no relation to the corporate enterprise must be beyond the authority of directors. As Vice Chancellor Wickens said in *Pickering v.*

Second
general
limitation.

¹ *Cass v. Manchester Iron and Steel Co.*, 9 Fed. Rep. 640. In this case the holder of a majority of stock had protested against the action of the directors.

² *Stevens v. Davison*, 18 Gratt. 819; *Mills v. Central R. R. Co.*, 41 N. J. Eq. 1; *Board, etc. Tippecanoe County v. Lafayette, etc. R. R. Co.*, 50 Ind. 85, 112; *Martin v. Continental Passenger Ry. Co.*, 14 Phila. (Pa.) 10. Nor can directors change the termini of a railroad. See *Board, etc. Tippecanoe County v. Lafayette, etc. R. R. Co.*, *supra*.

When the lease of the railroad of one company has been made to another railroad company, and ratified by the shareholders, the directors have no power, as against objecting shareholders, to change its provisions.

March v. Eastern R. R. Co., 43 N. H. 515. Compare *S. C.*, 40 N. H. 548. See *Kersey Oil Co. v. Oil Creek, etc. R. R. Co.*, 12 Phila. 374. Compare *Black v. Delaware and Raritan Canal Co.*, 22 N. J. Eq. 130, 407 *et seq.*, and § 224, note.

³ *Bank Commissioners v. Bank of Brest, Harrington's Ch. (Mich.)* 106; *Smith v. Smith*, 3 Des. Ch. (S. C.) 547; *Angell and Ames on Corp.* § 772. But it is held that directors may make an assignment of the corporate property for the equal benefit of all creditors, when the corporation is insolvent. *Descombes v. Wood*, 91 Mo. 196; *Hutchinson v. Green*, 91 Mo. 367. See § 225.

⁴ § 222.

⁵ § 267.

Stephenson:¹ "The special powers, given either to the directors or to a majority by statutes or other constituent documents of the association, however absolute in terms, are always to be construed as subject to a paramount and inherent restriction that they are to be exercised in subjection to the special purposes of the bond of association." Accordingly, directors have no power to give the note of the corporation for a debt having no relation to its business, due to the payee of the note; and the note will be void in the hands of any person having notice of the circumstances under which it was given.²

§ 232. On the other hand, if directors acting within the apparent scope of their authority, commit or intend a breach of trust, the rights of an innocent person dealing with them will not be affected thereby.³

Thus, if directors borrow money for their corporation, having authority to do so, the lender is not bound at his peril to see that the money is not applied to purposes *ultra vires* the corporation,⁴ nor embezzled by the directors. And if a person sells to directors for their corporation such property as it is authorized to buy, he need not ascertain whether it requires his particular property.⁵ In this last case, *Eastern Counties Railway Co. v. Hawkes*, Lord St. Leonards said that the English decisions⁶ did "not authorize directors to bind their companies by contracts foreign to the purposes for which they were established, but they do hold companies bound by contracts duly entered into by their directors for purposes which they have treated as within the objects of their Acts, and which cannot clearly be shown not to fall within them; and they further hold companies to be bound by a continual course of dealing by their directors with third persons in relation to their shares, although that mode of dealing is contrary to the regulations of their deed of management."⁷

¹ L. R. 14 Eq. 322, 340. See also *Minor v. Mechanics' Bank*, 1 Pet. 46, 71.

² *Hall v. Auburn Turnpike Co.*, 27 Cal. 255. See *Salem Bk. v. Gloucester Bk.*, 17 Mass. 30.

³ See § 203 *et seq.*

⁴ *In re Marseilles Extension Railway and Land Co.*, 20 W. R. 254.

⁵ *Eastern Counties R'y Co. v. Hawkes*, 5 H. L. Cas. 331.

⁶ *I. e.*, *National Exchange Co. v. Drew*, 2 Macq. 103; *Bargate v. Shortridge*, 5 H. L. Cas., 297.

⁷ 5 H. L. Cas., 381.

§ 233. As to what portion of their authority directors may delegate to some of their own number or to other officers of the corporation it is difficult to state any rule of general application more specific than this: directors may not delegate authority which it was intended that the board should exercise. From some cases it might indeed be inferred that it was ordinarily competent for them to delegate authority to perform mere ministerial acts, but not authority to do acts involving discretion.¹ Thus, it has been held that the power of directors to lease property of the corporation could not be delegated to an agent.² But this view is not borne out by the authorities.³

Directors may undoubtedly appoint subordinate officers, and empower them to do all acts which properly come within the scope of their respective offices.⁴ Such appointments, however, are rather an exercise than a delegation of their powers by directors; for clearly it was not intended that directors should perform the duties of subordinate officers. Directors may also regulate the authority of whatever officers they have the power to appoint. Accordingly, they may authorize the president, or president and cashier, or the general agent, to borrow money and draw and indorse negotiable paper in the name of the corporation;⁵ or may authorize a treasurer to assign mortgages belonging to the corporation.⁶

¹ *Silver Hook Road v. Greene*, 12 R. I. 164; *Farmers' Mutual Ins. Co. v. Chase*, 56 N. H. 341.

² *Gillis v. Bailey*, 21 N. H. 149; see *Tippets v. Walker*, 4 Mass. 595.

³ See *Burrill v. Nahant Bank*, 2 Metc. (Mass.) 163; *Hoyt v. Thompson's Ex'r*, 19 N. Y. 207; *Mercer County Ins. Co. v. Stranahan*, 104 Pa. St. 246.

⁴ *Kitchen v. Cape Girardeau, etc. R. R. Co.*, 59 Mo. 514. Unless, to be sure, the power of appointment remains with the body corporate. Directors usually receive express authority to appoint the higher officers as, *e. g.*,

the cashier. See *Fleckner v. Bank of the U. S.*, 8 Wheat. 338, 356.

⁵ *Ridgway v. Farmers' Bank*, 12 S. & R. 256; *Spear v. Ladd*, 11 Mass. 94; *Northampton Bank v. Pepoon*, 11 Mass. 288; *Fleckner v. Bank of the U. S.*, 8 Wheat. 338, 356; *Preston v. Missouri, etc. Lead Co.*, 51 Mo. 43; see *Merrick v. Bank of the Metropolis* 8 Gill (Md.), 59; *Bank Commissioners v. Bank of Buffalo*, 6 Paige, 497; *Manchester and Lawrence R. R. Co. v. Fisk*, 33 N. H. 297.

⁶ *Commonwealth v. Reading Savings Bank*, 137 Mass. 431.

§ 234. Powers involving a wide discretion—wider than should be vested in any single officer or subordinate agent—may be delegated by directors to a committee of their own number, especially when the membership of the board is large. In New York it is held that a board of twenty-three directors may delegate to a “quorum” of any five of their number authority to transact all ordinary business.¹ Likewise, a board may delegate to a committee of their own number authority to alienate or mortgage real estate of the corporation,² or to transfer its personal property.³ The power to do certain acts, however, the board of directors cannot delegate, even to a committee of their own number. They cannot delegate authority to allot shares,⁴ to make calls,⁵ to declare dividends,⁶ or to order a sale of shares for the non-payment of assessments.⁷

§ 235. It may be added that the power of agents, appointed by the board of directors, to act for the corporation, is not terminated by the expiration of the authority of the directors appointing them.⁸

¹ Hoyt v. Thompson's Ex'r, 19 N. Y. 207; see § 223. See Leavitt v. Oxford, etc. M. Co., 3 Utah, 265. But it has also been held that the authority possessed by a portion of the directors to do “ordinary business,” did not authorize them to compromise a large debt due the corporation. Kirk v. Bell, 16 Q. B. 290.

² Burrill v. Nahant Bank, 2 Metc. (Mass.) 163; Augusta Bank v. Hamblet, 35 Me. 491; Taylor v. Agricultural, etc. Ass'n, 68 Ala. 229; Hoyt v. Thompson's Ex'r., *supra*.

³ Mitchell v. Deeds, 49 Ill. 418; compare Palmer v. Yates, 3 Sandf. (N. Y.) 137.

⁴ *In re Leeds Banking Co.*, Howard's Case, 36 L. J. Eq. 42; S. C., L. R., 1 Ch. 561; *In re County Palatine Loan, etc. Co.*, Cartmell's Case, 43 L. J. Eq. 588; compare Crocker v. Crane, 21 Wend. 211. But au-

thority to delegate this power to a committee of their own number may be given in the corporate constitution. Harris's Case, L. R. 7 Ch. 587.

⁵ Silver Hook Road v. Greene, 12 R. I. 164; Farmers' Mutual Ins. Co. v. Chase, 56 N. H. 341 (in both the cases the delegation was to the treasurer); compare Read v. Memphis Gayoso Gas Co., 9 Heisk. (Tenn.) 545.

⁶ This power is especially confided to the discretion of the board, see § 562.

⁷ York and Cumberland R. R. Co. v. Ritchie, 40 Me. 425.

⁸ Anderson v. Langdon, 1 Wheat. 85; Northampton Bank v. Pepoon, 11 Mass. 288, 294; Dedham Bank v. Chickering, 3 Pick. 335; Union Bank v. Ridgely, 1 Har. & G. (Md.) 324, 431-2.

In regard to the authority of directors to release shareholders from their subscriptions see §§ 549-551, 745, 746, 780.

§ 236. To lay down any general rule, sufficiently definite to be of practical value, as to the powers of presidents of corporations is well nigh impossible.

Virtute officii a president has very little authority to act for his corporation, and can bind it only by such contracts as plainly come within its most ordinary routine business.¹ Thus, it is held that a president without special authority cannot borrow money and bind the corporation to repay it;² nor can he mortgage corporate property, or confess judgment on behalf of the corporation;³ nor has he authority to begin an action in the name of the corporation,⁴ or employ counsel.⁵ Neither has the president of a railroad corporation power to appoint an agent to sell its lands; and sales made by an agent appointed by the president will not bind the corporation;⁶ nor has the president authority himself to sell lands of the corporation.⁷ Likewise, the president of an insurance company has no authority *ex officio* to indorse and negotiate a note belonging to it.⁸ And when by the charter the management is intrusted to the board of directors, the president and cashier, unless

that of the directors who appoint them.

Authority of a president.

¹ First Nat. Bk. *v.* Hoch, 89 Pa. St. 324; *Blen v. Bear River, etc. Water Co.*, 20 Cal. 602; *Risley v. Indianapolis, etc. R. R. Co.*, 1 Hun, 202. See *Crump v. United States Mg. Co.*, 7 Gratt. 352; *Dawes v. North River Ins. Co.*, 7 Cow. 462; *Hodges v. Rutland, etc. R. R. Co.*, 29 Vt. 220. But compare *Hayner v. American Popular Life-Ins. Co.*, 3 J. & Sp. (N. Y.) 266.

² *Life and Fire Ins. Co. v. Mechanic Fire Ins. Co.*, 7 Wend. 31; *Fifth Ward Savings Bank v. First Nat. Bank*, 47 N. J. L. 357. In an action against an incorporated bank, declarations or admissions of its president are not admissible to establish liability against it. *Henry v. Northern Bank*, 63 Ala. 527. See *Hodge v. First Nat. Bk.*, 22 Gratt. 51.

³ *Stokes v. New Jersey Pottery Co.*, 46 N. J. L. 237; *England v. Dear-*

born, 141 Mass. 590. Although he own most of the stock; same cases.

⁴ *Ashuelot M'f'g Co. v. Marsh*, 1 Cush. 507. But see *American Ins. Co. v. Oakley*, 9 Paige, 496; *Mumford v. Hawkins*, 5 Denio, 355.

⁵ *Brightly v. Metairie Cemetery Ass'n*, 33 La. Ann. 58; see *Bridgeport Savings Bk. v. Eldridge*, 28 Conn. 556, and cases in the last note, contra, *Coleman v. Oil Co.*, 25 W. Va. 148. See *Wetherbee v. Fitch*, 117 Ill. 67. In a case of emergency a president may institute suit on his own authority. *Reno Water Co. v. Leete*, 17 Nev. 203.

⁶ *Chicago, etc. R. R. Co. v. James*, 22 Wis. 194.

⁷ *Bliss v. Kaweah Co.*, 65 Cal. 502; *McKeag v. Collins*, 87 Mo. 164.

⁸ *Marine Bank v. Clements*, 3 Bos. (N. Y.) 600. But see *Clark v. Titcomb*, 42 Barb. 122; *Scott v. Johnson*, 5 Bos. (N. Y.) 213.

specially authorized, have no power to assign choses in action of the corporation in payment of an antecedent debt, or to do any act requiring the use of the corporate seal,¹ and the lack of authority in the affixing of the seal may be shown by the corporation.² An agreement, moreover, by the president and cashier of a bank, that the indorser of a promissory note shall not be liable to the bank on his indorsement is invalid.³ Indeed, in a case where a respected court held a president incompetent to authorize a director to sell bonds of the corporation, the learned judge giving the opinion, said: "In the absence of anything in the act of incorporation, bestowing special power on the president, he has from his mere official station no more control over the corporate property and funds than any other director. The affairs of corporate bodies are within the exclusive control of their boards of directors, from whom authority to dispose of their assets must be derived."⁴

¹ Hoyt v. Thompson, 5 N. Y. 320; see England v. Dearborne, 141 Mass. 590. But it is held that a president may satisfy a judgment in favor of the corporation. Booth v. Farmers and Mechanics' Nat. Bk., 50 N. Y. 396.

² Koehler v. Black River Falls Iron Co., 2 Black. 715; Hoyt v. Thompson, 5 N. Y. 320.

³ Bank of the United States v. Dunn, 6 Pet. 51; Bank of the Metropolis v. Jones, 8 Pet. 12; First Nat. Bk. v. Tisdale, 18 Hun, 151. See United States v. City Bank, 21 How. 356; Hodge v. First Nat. Bk., 22 Gratt. 51. Compare Booth v. Farmers and Mechanics' Nat. Bk., 50 N. Y. 396; First Nat. Bk. v. Kimberlands, 16 W. Va. 555. One who is president and general manager of an insurance company has no authority to bind it by an accommodation indorsement. Aetna Nat. Bk. v. Insurance Co., 50 Conn. 167.

⁴ Titus v. Cairo and Fulton R. R. Co., 37 N. J. L. 98, 102, per Van

Syckel, J. See Fulton Bank v. New York Sharon Coal Co., 4 Paige, 127, 134; and Walworth County Bk. v. Farmers' Loan and Trust Co. 14 Wis. 325, where it was held that a president could not give a valid bill of sale for railroad ties in payment of an antecedent debt of his corporation. See also Union Gold Mg. Co. v. Rocky Mn. Nat. Bk., 2 Col. 565.

The affairs of the bank being by statute placed in hands of directors, the president and cashier have not power together, *virtute officii*, to sell the safe of a bank for an antecedent debt. Asher v. Sutton, 31 Kan. 286.

The president of a corporation organized under the New York Act of 1848, cannot bind it by the purchase of goods required in its business, when a resolution forbidding such acts appears on the corporate books, although the seller had no notice of it. There was no regular course of business in the corporation to the contrary, by which the president had habitually

§ 237. It is submitted, however, that the above decisions are to be relied on with great caution; for presidents of corporations are usually empowered, either expressly, ^{Enlarged by custom.} or impliedly by acquiescence and the nature and course of the business which they transact for their corporations, to do many acts which, according to any rule deducible from these cases, would be beyond their authority. Very likely in order that the agreement of a president may bind the corporation, the agreement must in some way be shown to have been within the scope of his authority;¹ but this may be shown from the general course of his acts acquiesced in by the corporation or its directors.²

§ 238. When a president is authorized to make contracts for the corporation, he receives impliedly the power to do acts incidentally necessary in the matter.³ Thus, a president empowered to sell property of his corporation, may agree to pay a broker a commission.⁴ So, a resolution of the board of directors that the president have full power and control of the corporate business, authorizes him to purchase materials to be

made such purchases. *Westerfield v. Radde*, 7 Daly, 326. A president of a railroad company has no authority to consent that a (municipal) subscription absolute on its face shall become conditional. *Morgan County v. Thomas*, 76 Ill. 120.

¹ *Farmers' Bk. v. McKee*, 2 Pa. St. 318.

² *Dougherty v. Hunter*, 54 Pa. St. 380. See *Westerfield v. Radde*, 7 Daly (N. Y.) 326; *Western R. R. Co. v. Bayne*, 11 Hun, 166; *Solomon R. R. Co. v. Jones*, 30 Kan. 601. The president and superintendent of a boom company have authority to hire laborers. *Hardy v. Boom Co.*, 52 Mich. 45; *Vilas Nat. Bk. v. Strait*, 58 Vt. 448.

When a president, who is also the general manager of the corporate business, mortgages personal property of the corporation without special author-

ity, the acquiescence of the directors may make the mortgage valid. *Sherman v. Fitch*, 98 Mass. 59. Compare *Crum's Appeal*, 66 Pa. St. 474; § 212.

³ A president of a corporation who has general authority to contract for the sale of its goods, has authority to release from contract of sale. *Indianapolis Rolling Mill v. St. Louis, etc. R. R. Co.*, 120 U. S. 256.

⁴ *Northern Central R'y Co. v. Bastian*, 15 Md. 494; *Lee v. Pittsburgh Coal Co.*, 56 How. Pr. 373, affirmed 75 N. Y., 601. Under a power given to the president of a turnpike company to mortgage the road, he may mortgage a part thereof. *Greensburgh, etc. Co. v. McCormick*, 45 Ind. 239. Where process can be served on the president, he can confess judgment for the corporation. *Chamberlin v. Mammoth M'g Co.*, 20 Mo. 96. *Sed quære.*

used in its business, and to borrow money for the corporation, giving its note for the loan.¹ Indeed, the custom of investing presidents with extensive powers is so general as to have obtained judicial recognition in at least one state, Illinois, where the following language was used by the judge giving the opinion of the court in *Smith v. Smith*:² "In the absence of legislative enactment or provision made in the by-laws, corporations usually act through their president, or those representing him. He being the legal head of the body, when an act pertaining to the business of the company is performed by him, the presumption will be indulged that the act is legally done, and is binding upon the body. And, as a general rule, in the absence of the president, or when a vacancy occurs in the office, the vice-president may act in his stead, and perform the duties which devolve upon the president."³

§ 239. Fully as important in his functions as a president is the cashier of a bank or other moneyed corporation. The cashier is the financial officer of the bank, having, in accordance with general custom, authority to transact its ordinary current business,⁴ and in the

¹ *Castle v. Belfast Foundry Co.*, 72 Me. 167. *Quære*, as to the extent to which such a sweeping resolution would be valid in view of the restricted competency of directors to delegate their powers, see §§ 233, 234. A by-law providing that the "president shall have the general charge and direction of the business of the company, as well as all matters connected with the interests and objects of the corporation," does not give him authority in matters expressly confided to the finance committee. *Twelfth Street Market Co. v. Jackson*, 102 Pa. St. 269.

It has, however, been held that a president, who was the "business and financial agent" of the corporation, could not, without further authority, mortgage its personal property. *Luse*

v. Isthmus Transit R'y Co., 6 Oreg. 125.

² 62 Ill. 493, 496. See also *Mitchell v. Deeds*, 49 Ill. 416, 424; *Union Mutual Ins. Co. v. White*, 106 Ill. 67; *Fitch v. Constantine Hydraulic Co.*, 44 Mich. 74; *Goodnow v. Oakley*, 68 Iowa, 25; *Morse v. Beale*, 68 Iowa, 463.

³ This case upheld, as against a subsequent purchaser under a tax sale, a deed of corporate lands executed by the vice-president, during a vacancy in the presidency, under a resolution authorizing the *president* to convey the property. Compare also *Curry v. Supervisors of Decatur County*, 61 Iowa, 71.

⁴ It is not negligent for a bank to intrust its cashier to select and pay out of his salary all the clerks and other

performance of his duties his acts bind the bank.¹ As Justice Story said, in *Wild v. Bank of Passamaquoddy*:² “The cashier of a bank is, *virtute officii*, generally intrusted with the notes, securities, and other funds of the bank, and is held out to the world by the bank as its general agent in the negotiation, management, and disposal of them. *Prima facie*, therefore, he must be deemed to have authority to transfer and indorse negotiable securities held by the bank for its use and in its behalf. No special authority for this purpose is necessary to be proved. If any bank choose to depart from this general course of business, it is certainly at liberty so to do; but in such case it is incumbent on the bank to show that it has interposed a restriction, and that such restriction is known to those with whom it is in the habit of doing business.”³

§ 240. Accordingly, a bank will be liable to an outsider acting in good faith, for the contracts as well as for the frauds of its cashier made or committed while acting within the ordinary scope of the powers and duties pertaining to his office,⁴ or

servants employed in the banking room; no negligence appearing in the selection of the cashier. *Smith v. First National Bank*, 99 Mass. 605.

¹ *Lloyd v. West Branch Bank*, 15 Pa. St. 172.

² 3 Mason, 505, 506.

³ See also *State v. Commercial Bank*, 14 Miss. 218. That a cashier has authority to transfer and indorse negotiable paper belonging to his bank is undoubted. *City Bank v. Perkins*, 29 N. Y. 554; *Hartford Bank v. Barry*, 17 Mass. 94. See *Caldwell v. Nat. Mohawk Valley Bank*, 64 Barb. 333; *Robb v. Ross County Bank*, 41 Barb. 586; *Burnham v. Webster*, 19 Me. 234; *Potter v. Merchants' Bank*, 28 N. Y. 641. Likewise a cashier has general authority to superintend the collection of notes under protest. *Bank of Pennsylvania v. Reed*, 1 Watts & S. 101.

Where a vice-president who was

also a director, with the knowledge of the president and the cashier, but without notice to the board of directors, guarantees on behalf of the bank the payment of a note belonging to it, the bank, by using the proceeds of the note, renders the act of the vice-president as binding as if expressly authorized. *People's Bank v. National Bank*, 101 U. S. 181.

⁴ A cashier has the implied power to borrow on behalf of his bank and pledge its property to secure the repayment of the loan. *Coats v. Donnell*, 94 N. Y. 168. In order to show a cashier's authority to borrow for his bank, special power from the directors is not essential. His acts in the ordinary course of his employment are evidence. *Ringling v. Kohn*, 6 Mo. App. 333; *Donnell v. Lewis County Savings Bank*, 80 Mo. 165. The cashier of a bank as its executive officer, having charge of its whole moneyed trans-

within the scope of such further authority as may have been conferred on him by the constitution of the bank, or by the action or acquiescence of the directors or shareholders.¹ Consequently, notice to the cashier in regard to the ordinary business dealings of the bank is notice to it;² and it is affected with the knowledge of its cashier who takes a note knowing the same to have had a fraudulent inception.³ Accordingly, if a cashier takes securities for his bank from a trustee to secure a loan made to the trustee individually, knowing that the trustee holds them in trust, the bank is affected with the knowledge of its cashier.⁴

§ 241. But the duties and powers of a cashier, as recognized judicially, are restricted to the transaction of the ordinary business of the bank and to the care and management of its affairs in the usual way.⁵ Thus,

Cashier's
power re-
stricted to
transac-

actions in paying and receiving the payment of debts, and discharging and transferring securities, has authority to take such measures as he deems proper for the securing and eventual collection of a debt, and to compromise a debt according to the course of business. *Bridenbecker v. Lowell*, 32 Barb. 9; see *Wakefield Bank v. Truesdell*, 55 Barb. 602. But see *Sandy River Bk. v. Merchants', etc. Bk.*, 1 Biss. 146.

It is in general within the authority of a cashier to sign a blank transfer on a certificate of stock, held by the bank as collateral security, and to deliver the certificate to the pledgor; and thus signing a transfer warrants the genuineness of the certificate, so that a *bona fide* transferee for value from the fraudulent pledgor can hold the bank liable. *Matthews v. Massachusetts Nat. Bk.*, 1 Holmes, 396. So a bank was held liable where a cashier negotiated, through an agent, a certificate of deposit, although no deposit had been made and the cashier embezzled the proceeds of the transaction. *Barnes*

v. Ontario Bank, 19 N. Y. 152. Compare *Reynolds v. Kenyon*, 43 Barb. 515; *Mapes v. Second Nat. Bk.*, 80 Pa. St. 163; *Foster v. Essex Bk.*, 17 Mass. 479; *State v. Atherton*, 40 Mo. 209; *Morris Canal, etc. Co. v. Van Vorst*, 21 N. J. L. (1 Zab.) 109; *Loring v. Brodie*, 134 Mass. 453.

¹ Thus, when the cashier has general charge of stock transfers, his acts in regard thereto bind the bank, which will be liable for his wrongful refusal to permit a transfer. *Case v. Bank*, 100 U. S. 446; see *National Bank v. Watson*, 105 U. S. 217.

² *New Hope, etc. Bridge Co. v. Phoenix Bank*, 3 N. Y. 156. As to declarations of cashier, see *Xenia Bank v. Stewart*, 114 U. S. 224.

³ *Fall River Union Bk. v. Sturtevant*, 12 Cush. 372. So, by the knowledge of a director who takes a note. *Nat. Security Bk. v. Cushman*, 121 Mass. 490.

⁴ *Loring v. Brodie*, 134 Mass. 453.

⁵ *First Nat. Bank v. Ocean Nat. Bank*, 60 N. Y. 278. The word "ordinary," as here used, will be seen to

the cashier (and president) of a bank cannot bind it by their agreement with an indorser of a promissory note that he shall not be liable to the bank on his indorsement.¹ The cashier has no power to bind his bank as an accommodation indorser on his individual note; and the payee failing to prove that the cashier had authority to make the indorsement cannot recover against the bank.² Likewise a cashier cannot on behalf of his bank guarantee the performance of a contract by an outsider in which the bank had no interest.³

And it was held in *United States v. City Bank of Columbus*⁴ that a cashier had no authority to empower a director to contract with the secretary of the treasury for the transportation of moneys belonging to the United States, and consequently that the bank was not liable to reimburse money delivered by the secretary to the director in pursuance of such contract. Giving the opinion of the Court, Justice Wayne said: "In the case of *Bank of the United States v. Dunn* (6 Pet. 51) the court would not permit the president and cashier of the bank to bind it by their agreement with the indorser of a promissory note

be more restricted in its meaning than as applied to transactions falling within the powers of directors. See § 223.

¹ *Bank of the U. S. v. Dunn*, 6 Pet. 51; *Bank of the Metropolis v. Jones*, 8 Pet. 12. See *Coheco Nat. Bank v. Haskell*, 51 N. H. 116. Compare *Payne v. Commercial Bank*, 6 Smedes & M. 24; *Hodge v. First Nat. Bank*, 22 Gratt. 51; *Ryan v. Dunlop*, 17 Ill. 40. So, the plea that before indorsing, the cashier and a director falsely and fraudulently assured the indorser that the drawer was good, and that it would be safe to indorse, is bad; as such representations are not within the course of the duties of such officers, and therefore, though wilfully false, will not affect the rights of the bank. *Mapes v. Second Nat. Bank*, 80 Pa. St. 163. "A cashier, as such, has no power to accept a note signed by two parties only, in payment and

discharge of a note upon which another party was also bound with the two, so as to relieve such third party from his indebtedness to the bank. Such an act does not fall within the well-known range of powers and duties naturally and necessarily pertaining to the office of cashier. He cannot *virtute officii* release a surety upon a note even though the bank holds other security to which it might resort, nor make collateral contracts or agreements of any kind." *Ecker v. First Nat. Bank*, 59 Md. 291, 303.

² *West St. L. Savings Bank v. Shawnee County Bank*, 95 U. S. 557. A cashier cannot certify his own check. *Lee v. Smith*, 84 Mo. 304. Compare *People's Bank v. Nat. Bank*, 101 U. S. 181; § 239.

³ *Norton v. Derby Nat. Bank*, 61 N. H. 589.

⁴ 21 How., 356.

that he should not be liable on his indorsement. It said it is not the duty of the cashier and president to make such contracts, nor have they power to bind the bank except in the discharge of their ordinary duties. All discounts are made under the authority of the directors, and it is for them to fix any conditions which they may think proper in loaning money. The court defines the cashier of a bank to be an executive officer, by whom its debts are received and paid, and its securities taken and transferred, and that his acts, to be binding upon a bank, must be done within the ordinary course of his duties. His ordinary duties are to keep all the funds of the bank, its notes, bills, and other choses in action, to be used from time to time for the ordinary and extraordinary exigencies of the bank. He usually receives directly, or through the subordinate officers of the bank, all moneys and notes of the bank, delivers up all discounted notes and other securities when they have been paid, draws checks to withdraw the funds of the bank, when they have been deposited, and, as the executive officer of the bank, transacts most of its business.

“The term ordinary business with direct reference to the duties of cashiers of banks, occurs frequently in English cases, and in the reports of the decisions of our state courts, and in no one of them has it been judicially allowed to comprehend a contract made by a cashier without an express delegation of power from a board of directors to do so, which involves the payment of money, unless it be such as has been loaned in the usual and customary way. Nor has it ever been decided that a cashier could purchase or sell the property, or create an agency of any kind for a bank, which he had not been authorized to make by those to whom has been confided the power to manage its business, both ordinary and extraordinary.”¹ In a recent case the Federal Supreme Court expressed its views

¹ *United States v. City Bank*, 21 How. 364. Without authority from the bank, evidenced by a resolution of the board of directors, usage in similar cases, or in some other way, a cashier has no authority to assign a non-negotiable note. *Barrick v. Aus-*

tin, 21 Barb. 241; *Holt v. Bacon*, 25 Miss. 567. But see *Bank of Vergennes v. Warren*, 7 Hill, 91. Nor to pledge assets of the bank for the payment of an antecedent debt. *State of Tennessee v. Davis*, 50 How. Pr. (N. Y.) 447.

regarding the powers of a cashier substantially as follows: Although a cashier has no power by virtue of his office to bind the bank, except in the discharge of his ordinary duties, and the ordinary business of a bank does not comprehend a contract made by a cashier involving the payment of money not loaned by the bank in the customary way, and a cashier may not, in the absence of authority conferred by the directors, cancel its deeds of trust given as security for money loaned, certainly not, unless the debt is paid; still a bank may be represented by its cashier, at least where its charter does not otherwise provide, in transactions outside of his ordinary duties, without his authority to do so being in writing or appearing upon the record of the proceedings of the directors. His authority may be proved by parol and collected from circumstances, or inferred from the general manner in which, for a period sufficiently long to establish a settled course of business, he has been allowed without interference to conduct the affairs of the bank. It may be implied from the conduct or acquiescence of the corporation, as represented by the board of directors. When during a series of years, or in numerous business transactions, he has been permitted, without objection, and in his official capacity, to pursue a particular course of conduct, it may be presumed, as between the bank and those who in good faith deal with it upon the basis of his authority to represent the corporation, that he has acted in conformity with instructions received from those who have the right to control its operations.¹

§ 242. In concluding the discussion of the powers of cashiers, it will be convenient to consider the liability of banks on checks certified by the cashier, or, as nowadays is more usual, by the paying teller.²

Certification of checks.

¹ *Martin v. Webb*, 110 U. S. 71; which held that the cancellation by the cashier of trust deeds, belonging to the bank, without receiving for it payment in full, bound the bank under the circumstances. A cashier has no authority to assign discounted bills and notes

to a depositor in payment of his deposit. *Lamb v. Cecil*, 25 W. Va. 288.

² The liability of banks for special deposits and for the frauds or felonies of their cashiers regarding the same, is discussed in §§ 161, 337.

§ 243. The leading case on the power of a cashier to certify checks is *Merchants' Bank v. State Bank*.¹ That case decided that if a cashier is shown to have frequently pledged in writing the credit of his bank for large amounts in the usual course of business with the knowledge of the directors—borrowing and lending its money, and buying and selling exchange—doing all this usually on the cashiers' own checks, though sometimes by certificates of deposit, and sometimes by memoranda, the transactions being uniformly made on the faith of the implied powers of the cashier, without inquiry as to special authorization, and such is shown to be the usage of other banks, this is evidence from which a jury may infer that the cashier is authorized to pledge the bank's credit by certifying a check to be "good;" even though it is not shown that any cashier of any bank in the place where the transaction occurred ever made such a certification. In this case the certified check was given by the cashier of the defendant bank to the cashier of the plaintiff bank, on receipt by the defendant's cashier from the plaintiff's cashier of the equivalent of the check in gold. Whether the gold actually went into the defendant bank did not appear; but the plaintiff bank acted in entire good faith, and the circumstances of the transaction warranted the assumption that the gold was destined for the defendant bank. Giving the opinion of the majority of the court, Justice Swayne said:² "The cashier is the executive officer, through whom the whole financial operations of the bank are conducted. He receives and pays out its moneys, collects and pays its debts, and receives and transfers its commercial securities. Tellers and other subordinate officers may be appointed, but they are under his direction, and are, as it were, the arms by which designated portions of his various functions are discharged. A teller may be clothed with the power to certify checks, but this in itself would not affect the right of the cashier to do the same thing. The directors may limit his authority, as they deem proper, but this would not affect those to whom the limitation was unknown."

§ 244. It has been held in Massachusetts that a teller has no authority, by virtue of his office, to certify a check;³ but at

¹ 10 Wall. 604.

² *Mussey v. Eagle Bank*, 9 Metc.

³ 10 Wall. 650.

(Mass.) 306.

present for tellers to certify checks seems to be a general custom, which obtains recognition in the courts.¹ Neither a cashier nor a teller, however, has power to certify, unless the drawer has funds in the bank sufficient to cover; and no person knowing the drawer not to have funds in the bank can recover on the certification.²

Certification by teller. Accommodation certifications.

But a *bona fide* holder for value of a certified check without notice, can hold the bank on its teller's certification, although the drawer had no funds in the bank at the time, and the teller certified the check in violation of his duty for the mere accommodation of the drawer;³ for a person is entitled to assume that the facts exist, on which depends the right of the teller or cashier to exercise his powers; and may presume that such officers are doing, not violating, their duty. As Judge Selden said, giving the opinion of the court in *Farmers and Mechanics' Bank v. Butchers and Drovers' Bank*:⁴ "A citizen who deals directly with a corporation, or who takes its negotiable paper, is presumed to know the extent of its corporate powers. But when a paper is upon its face in all respects such as the corporation has authority to issue, and its only defect consists in some extrinsic fact, such as the purpose or object for which it was issued, to hold that the person taking the paper must inquire as to such extraneous fact, of the existence of which he is in no way apprised, would obviously conflict with the whole policy of the law in regard to negotiable paper."⁵

¹ See *Farmers and Mechanics' Bank v. Butchers and Drovers' Bank*, 16 N. Y. 125.

² *F. and M. Bank v. B. and D. Bank*, 16 N. Y. 125; *S. C.*, 14 N. Y. 623. A bank is usually not authorized to make an accommodation indorsement, and is not liable to any one taking the paper with notice of the character of the indorsement. *Bank of Genesee v. Patchin Bank*, 13 N. Y. 309; *Morford v. Farmers' Bank*, 26 Barb. 568. That a cashier has no power to certify unless in funds is presumed to be known generally; and that a post-dated check was certified

before the day on which it was payable, is a fact sufficient to put any one with knowledge of it on his inquiry. *Clarke Nat. Bank v. Bank of Albion*, 52 Barb. 592. See *Pope v. Bank of Albion*, 57 N. Y. 126.

³ *F. and M. Bank v. B. and D. Bank*, *supra*.

⁴ 16 N. Y., 129.

⁵ *Acc. Meads v. Merchants' Bank*, 25 N. Y. 143; *Cooke v. State Nat. Bank*, 52 N. Y. 96.

A corporation is bound by its accommodation indorsement to a *bona fide* holder for value of a note, who discounts it before maturity on the

§ 245. By certifying a check in the usual form a bank certifies to the genuineness of the drawer's signature, represents that he has funds in the bank sufficient to meet the check, and engages that those funds shall not be withdrawn by him to the prejudice of any *-bona fide* holder of the check. But the certification is not an absolute guaranty that the body of the check—the amount and name of the payee—is genuine; nor is it a guaranty that at all events the precise check certified shall be paid from funds of the drawer in the bank, or at all. Therefore, when a bank certifies a check which was raised before certification (the bank not being negligent in the matter), it cannot in consequence of its certification be held to pay the amount of the raised check; and when, without negligence, a bank pays the amount of a raised check which it has certified, it cannot recover the money thus paid as money paid by mistake.¹ So, if subsequently to the certification the check is raised, and then sent by some one to the bank to ascertain whether the certification is correct, and the teller says that it is, this answer will cover no more than the certification of a check already raised would have covered, and will not render the bank liable to pay the amount of the check.²

§ 246. The legal effect is similar when an uncertified check is sent to the bank for information. The law presumes knowledge on the part of the bank only of the drawer's signature and the state of his account; and a verbal statement that the check is "good," or "all right," extends only to the matters of which the bank is presumed to have knowledge, unless the teller's attention is especially directed beyond those matters. And if the bank subsequently pays the check to the person

faith of its being business paper. *v. Nat. Mechanics' B'k'g Ass'n*, 55 *Mechanics' Banking Ass'n v. New* N. Y. 211. *Second Nat. Bank v. York, etc. White Lead Co.*, 35 N. Y. Western Nat. Bank, 51 Md. 128; and compare *Helwege v. Hibernia Nat. Bank*, 28 La. Ann. 520. But see, contra, *Louisiana Nat. Bank v. Citizens' Bank*, 28 La. Ann. 189.

¹ *Clews v. Bank of New York*, 89 N. Y. 418; *Marine Nat. Bank v. Nat. City Bank*, 59 N. Y. 67; *Security Bank v. Nat. Bank*, 67 N. Y. 458; *Espy v. Bank of Cincinnati*, 18 Wall. 604. See *Nat. Bank of Commerce* ² *Clews v. Bank of New York*, 89 N. Y. 418. (See a criticism on this case in the following note.)

who sent it to the bank for information (or *seem* to any one else), it may recover back the money if the check turns out to have been raised. For the general principle is that money paid by mistake on a raised check may be recovered back.¹

¹ *Espy v. Bank of Cincinnati*, 18 Wall. 604; *Corn Exchange Bank v. Nassau Bank*, 91 N. Y. 74; *Frank v. Lanier*, ib. 112. See § 672 for the responsibility of a bank that pays a check to which the drawer's or indorser's signature is forged.

A teller is an agent acting under a special or express authority, and not one so appointed by a principal that there can arise any implication of undefined powers; and a teller's statement that an indorsement on a check is good will not bind the bank, when the indorser is not a customer of the bank, and the statement is made at the request of a stranger, and not in the ordinary course of defendant's business. *Walker v. St. Louis Nat. Bank*, 5 Mo. App. 214. When there is a receiving as well as a paying teller, the former alone has authority, by virtue of his office, to receive deposits. A paying teller (when there is a receiving teller) in receiving funds from a stranger upon a promise to apply them in payment of a bill or note, is the agent of the stranger, not of the bank; and consequently, the bank will not be liable for a breach or neglect of the duty which the teller assumes. *Thatcher v. Bank of the State of N. Y.*, 5 Sand. 121 (said to have been affirmed in the Court of Appeals).

The situation where a person sends an uncertified check to a bank to inquire whether it is good, as in *Espy v. Bank of Cincinnati*, differs from *Clews*

v. Bank of New York in a point that leads the writer to doubt the correctness of the decision in the latter case, in which, indeed, Judge Danforth gave an able dissenting opinion. Since the bank is presumed to know only its depositor's signature and the state of his account, anything further that a teller might say in regard to an uncertified check would presumably, as well as in the nature of things, be merely the expression of his opinion (*e. g.*, as to whether the check had been raised). But when a certified check is sent to the bank for information, the case is different, as by turning to his book the teller may ascertain whether on the day when the check is dated he certified a check for the drawer, for the face of the check shown him. If the teller had done this in the *Clews* case, he would not only have found that he had certified no such check, but would also have seen an entry made of a letter received by the bank notifying it not to pay the check which on that day it had certified for the drawer, which was the check afterwards raised. The court relied on the point that the bank owed no duty to *Clews & Co.* in the matter. But, admitting that the bank was under no duty to *Clews & Co.* to give them any information at all, it still seems to the writer, that since it did give them information, it owed them the duty to take reasonable care that the information was correct. The teller ought to have looked in his book.

§ 247. Having considered the powers of corporate agents and the legal effect, between the corporation and persons with whom they transact business, of their acts as depending on their actual power, and on such power as the corporation is estopped to deny that they possess, it is now necessary to consider the legal effect of acts done on behalf of a corporation as depending on the manner in which these acts are done, and on the observance of formalities required or directed to be observed in doing them.¹

§ 248. The old common law notion, that a corporation can act only by deed under its corporate seal, has long since dropped from the law;² and to-day a corporation need use its seal only when it would be essential for an individual to use one.³ Accordingly, the use of the corporate seal is not essential to the valid appointment of an agent;⁴ and a corporation may be bound by the oral or written contracts of its agents, which are neither authorized nor executed under the corporate seal.⁵ Further, a contract may bind the

Validity of the acts of corporate agents as dependent on formalities.

Use of corporate seal.

¹ The manner in which the body corporate should act is discussed, § 184.

² See *Bank of Columbia v. Patterson*, 7 Cranch, 299; *Bank of U. S. v. Dandridge*, 12 Wheat. 64; *Savings Bank v. Davis*, 8 Conn. 191.

³ *Crawford v. Longstreet*, 43 N. J. L. 325. A stock certificate need have no seal. *Halstead v. Dodge*, 19 J. & S. (N. Y.) 169.

⁴ *Bank of Columbia v. Patterson*, 7 Cranch, 299, 305; *Randall v. Van Vechten*, 19 Johns. 60; *Reynolds v. Collins*, 78 Ala. 94; *Leekins v. The Nordyke, etc. Co.*, 66 Iowa, 471; *Bancroft v. Wilmington Conference Acad.*, 5 Houst. (Del.) 577; *Angell and Ames on Corp.*, § 283. This holds true although the agent be appointed to convey or mortgage real estate of the corporation. *Despatch Line v. Bellamy M'fg Co.*, 12 N. H. 205; *Cook v. Kuhn*, 1 Neb. 472.

⁵ *Fleckner v. U. S. Bank*, 8 Wheat.

358; *Bank of the Metropolis v. Guttschlick*, 14 Pet. 19; *Chesapeake and Ohio Canal Co. v. Knapp*, 9 Pet. 541; *Trustees of Christian Church v. Johnson*, 53 Ind. 273; *Racine and Miss. R. Co. v. Farmers' Loan and Trust Co.*, 49 Ill. 331; *Hoag v. Lamont*, 60 N. Y. 96; *Angell and Ames on Corp.*, § 237.

Unless prohibited by statute or other positive regulation a valid contract of insurance may be made by parol. *Relief Fire Ins. Co. v. Shaw*, 94 U. S. 574.

"Whenever a corporation is acting within the scope of the legitimate purposes of its institution, all parol contracts made by its authorized agents are *express* promises of the corporation; and all duties imposed on them by law, and all benefits conferred at their request, raise *implied* promises for the enforcement of which an action may well lie." Story, J., in *Bank of Columbia v. Patterson*, 7 Cranch, 299.

corporation although the officers making it use their private seals.¹ But a contract so executed is not the *deed* of the corporation; and if suit is brought on it against the corporation in a court where the old forms of action are preserved, the proper action is *assumpsit* and not *covenant*:² while, if the contract had been under the corporate seal, *assumpsit* would not lie.³ Indeed not a few cases hold that a corporation may bind itself in any way in which an individual can.⁴

§ 249. Moreover, not only by the *express* contracts of its agents may a corporation be bound. When, had the agent been acting for a natural principal his acts ^{Implied contracts.} would have raised implied promises on the part of the latter, or would have affected him with implied obligations, similar implied promises and obligations will be held to arise on the part of the corporation.⁵ Thus, if labor is performed

¹ *Eureka Co. v. Bailey Co.*, 11 Wall. 488; *Randall v. Van Vechten*, 19 Johns. 60. See *Whitford v. Laidler*, 94 N. Y. 145, 151.

² *Bank of the Metropolis v. Guttschlick*, 14 Pet. 19; *Whitford v. Laidler*, *supra*. The *deed* of a corporation can be proved only by proving that the seal affixed is the seal of the corporation, or that it was affixed as the corporate seal by an officer of the corporation or other person, thereunto duly authorized. *Osborne v. Tunis*, 25 N. J. L. (1 Dutch.) 633.

³ *Marine Ins. Co. v. Young*, 1 Cranch, 332.

⁴ *Kelly v. Board of Public Works*, 75 Va. 263; *Blunt v. Walker*, 11 Wis. 334. "Corporations, with the express and substantive powers conferred by their charters, take by implication all the reasonable modes of execution which a natural person may adopt in the exercise of similar powers." *New England Fire Ins. Co. v. Robinson*, 25 Ind. 536, 541.

⁵ See *Bank of Columbia v. Patterson*, *supra*. *Hayden v. Middlesex*

Turnpike Co., 10 Mass. 397; *Gowen Marble Co. v. Tarrant*, 73 Ill. 608; *Foulke v. San Diego*, etc. R. R. Co., 51 Cal. 365; *Pixley v. Western Pacific R. R. Co.*, 33 Cal. 183; *Tyler v. Trustees*, 14 Ore. 485. When a person is induced to become surety by the representations of the secretary of a building association, the association cannot allege want of authority in its agent to bind it by his representations, and at the same time take the benefit of the contract made by him. *Jones v. Nat. B'ld'g Ass'n*, 94 Pa. St. 215. Compare *Gass v. Citizens' Building Ass'n*, 95 Pa. St. 101. To render a surety liable no formal evidence of the acceptance of the bond is necessary. *Bostwick v. Van Voorhis*, 91 N. Y. 353.

A corporation owes to sureties on the bonds of its officers good faith, but not diligence. *Sparks v. Farmers' Bank*, 3 Del. Ch. 274; *Wilmington*, etc. R. R. Co. v. *Ling*, 18 S. C. 116; *Batchelor v. Planters' Nat. Bk.*, 78 Ky. 435; *Mutual Loan*, etc. Ass'n v. *Price*, 16 Fla. 204; *Bennett v. S. A. R. E.*

for a corporation at the request of its general agent, the corporation may be held to pay for it on a *quantum meruit*.¹

§ 250. When a provision in the constitution of a corporation prescribes either the manner of doing an act or certain formalities as prerequisite, careful distinctions must be drawn; for the legal effect of omitting the formalities, or of doing the act in a manner other than that indicated, will depend on whether the provision was imperative or only directory; whether it provided a manner in which the act must be done, or only indicated a manner in which it might be done;² whether the formalities prescribed were conditions precedent to the validity of the act or not.³

§ 251. It is impossible to state any general rule by which, in every instance, or even in most instances, may be determined whether a provision of this character is imperative or directory. It is clear, however, that if the provision is contained in some instrument, of which the person dealing with the corporate agent has no knowledge, and with knowledge of which he is in no way affected, the provision will not affect his rights;⁴ and so if the formality prescribed is one that, under the circumstances, the person dealing with the corporate representative is justified in assuming to have been performed, his rights will not be affected by its non-performance.⁵ Just as a person dealing with a corporate agent is entitled to assume, in regard to the substance of the transaction, that the agent is not acting wrong-

B. & L. Ass'n, 57 Tex. 72; Chew v. Ellingwood, 86 Mo. 260. For the liability of sureties on the bonds of corporate officers, see Barry v. Screwmen's Association, 67 Tex. 250, and Thompson on the "Liability of Officers and Agents of Corporations," chap. vi.

¹ Goodwin v. Union Screw Co., 34 N. H. 378. Similarly in selling materials a corporation may be held on implied warranties, like an individual. See Kellogg Bridge Co. v. Hamilton, 110 U. S. 108.

² "It needs no authority to establish, that if a general statute prescribe the mode or modes in which corporations must contract, a contract made in any other mode will not be binding upon the corporation or the party contracting with it, unless the statute, as it sometimes does, provides to the contrary." Angell and Ames on Corp., § 253.

³ See Bank of U. S. v. Dandridge, 12 Wheat. 64.

⁴ See § 198.

⁵ See § 203.

fully,¹ so such a person is entitled to assume that the corporate agent is acting regularly, and that the antecedent formalities and the regulations relating to the internal management of the affairs of the corporation have been complied with.

The law on this subject has been lucidly stated in a recent case in the New Jersey Court of Error and Appeals,² as follows: "Persons taking securities of this character³ are chargeable with knowledge of the power to make them as conferred by the charter. If the power granted by the charter is subject to a condition, relating either to the form in which the security shall be made in order to be valid, or to some preliminary proceeding extraneous to the acts of the corporation or its officers, securities issued not in the prescribed form, or without the preliminary proceedings had, are subject to defences in consequence thereof, even in the hands of *bona fide* holders. Thus, where the statute required such bonds to be certified across their face, and to be registered, and declared that no bonds should be valid unless so registered, bonds issued without such registry and certificate were held to be void. *Morrison v. Inhabitants of Bernards*, 7 Vroom, 219. So also where the statute requires, as a preliminary to the issuing of bonds by a county, town, or other corporation, that the assent of a certain proportion of voters or tax-payers shall first be obtained, this requisite is essential, and the absence of it will avoid the bonds, even as against innocent third parties.⁴

"But this doctrine does not prevail in those instances in which the right to issue such securities is by the charter conditioned upon the performance of acts by the corporation or its officers relating to the management of the affairs of the company. In such cases, as said by Vice-Chancellor Wood, 'if the party contracting with the directors finds the acts to be within the scope of their power under the deed of settlement, he has a right to assume that all such conditions have been complied with.'⁵ . . .

¹ See § 204.

² *Hackensack Water Co. v. De Kay*, 36 N. J. Eq. 548, 562.

³ Negotiable securities issued by a corporation.

⁴ Citing *Hudson v. Inhabitants of Winslow*, 6 Vroom, 437, a case of municipal bonds. See § 315 *et seq.*

⁵ *In re Athenæum Society Ex parte Eagle Co.*, 4 K. & J. 549. See also

“The doctrine which validates securities within the apparent powers of the corporation, but improperly, and therefore illegally issued, applies only in favor of *bona fide* holders for value. A person who takes such a security with knowledge that the conditions on which alone the security was authorized were not fulfilled, is not protected, and in his hands the security is invalid, though the imperfection is in some matter relating to the internal affairs of the corporation, which would be unavailable against a *bona fide* holder of the same security.”¹

§ 252. The principles just stated are applicable to provisions requiring the contracts of certain corporate agents to be approved by other corporate agents. Such provisions will not affect the rights of a person acting in good faith in ignorance that the agent with whom he deals is not acting with due regularity.²

§ 253. So far as to the effect of the non-observance of formalities when the person dealing with the corporate agent does not know of them, or reasonably assumes that they have been complied with. If, however, a person actually knows or is affected with notice of formalities, and his contract with the corporate representative is in a form indicating their non-observance, he acts at his peril,³ and may be unable to hold the corporation, unless the formality required was trivial or had been systematically disregarded in the course of the corporate business.⁴ For the corporation may rightfully plead that it is not bound to a party contracting with its agent knowing of the neglect of formalities which it or the legislature has established for its protection. Accordingly, if the contracting party is in

Connecticut Mut. Life Ins. Co. v. Cleveland, C. and C. and C. R. R. Co., 41 Barb. 9; Berks, etc. Turnpike Road v. Myers, 6 S. & R. 12; Royal British Bank v. Turquand, 6 El. & Bl. 327; Webb v. Commissioners, L. R. 5 Q. B. 642; Mahony v. East Holyford M'g Co., L. R. 7 H. L. 893, 894.

¹ 36 N. J. Eq. 565. See also Nichols v. Mase, 94 N. Y. 160.

² Medbury v. New York and Erie R. R. Co., 26 Barb. 564.

³ See Dana v. Bank of St. Paul, 4 Minn. 385; Hackensack Water Co. v. De Kay, *supra*, § 251.

⁴ Leonard v. American Ins. Co., 97 Ind. 299; Bulkley v. Derby Fishing Co., 2 Conn. 252; Kilgore v. Bulkley, 14 Conn. 362; compare *In re Royal British Bank*, Walton's Case, 26 L. J. Ch. 545.

any way affected with knowledge that the contract to bind the company should be signed by certain officers, unless it is signed by those officers the corporation will not be bound.¹

§ 254. On the other hand, if by a reasonably liberal construction in favor of a person who acts in good faith, although affected with notice of the provisions requiring the formalities, those provisions may be construed to be inapplicable to the contract on which his rights are based, courts will gladly avoid holding the contract invalid.² Moreover, if the variance between the manner prescribed and the manner in which the contract was actually executed is obviously immaterial, his rights will not be affected. Thus, the charter of a corporation required a certain number of managers "to constitute a quorum with power to enter into a contract." The contract before the court was actually sealed and executed by a less number; but the court held it valid, there being no evidence to show that it had not been *authorized* by the requisite number.³

§ 255. In certain cases where, as a matter of fact, the person contracting with the corporate agent is far less conversant with the nature of the business in hand than the corporation and its agent, the court has permitted him, when he has in entire good faith performed his side of the contract, to hold the corporation; although some formality with knowledge of which he must be

When corporate agent and contracting party do not stand on equal terms.

¹ Head v. Providence Ins. Co., 2 Cranch, 127; Holbrook v. Fauquier, etc. Turnpike Co., 3 Cranch, Cir. Ct., 425; Henning v. United States Ins. Co., 47 Mo. 425; Salem Bank v. Gloucester Bank, 17 Mass. 1; Badger v. American Popular Ins. Co., 103 Mass. 244; Beatty v. Marine Ins. Co., 2 Johns. 109. Compare Barnes v. Ontario Bank, 19 N. Y. 152; Safford v. Wyckoff, 4 Hill, 446; Melvin v. Lisenby, 72 Ill. 63; Dana v. Bank of St. Paul, 4 Minn. 385; and cases in the last note.

² See Trustees First Baptist Church v. Brooklyn Fire Ins. Co., 19 N. Y. 305; Relief Fire Ins. Co. v. Shaw, 94

U. S. 574; New England Ins. Co. v. DeWolf, 8 Pick. 56; Dana v. Bank of St. Paul, 4 Minn. 385; Insurance Co. v. Colt, 20 Wall. 560; Sanborn v. Fireman's Ins. Co., 16 Gray, 448; Mechanics' Bank v. Bank of Columbia, 5 Wheat. 326; Rockwell v. Elkhorn Bank, 13 Wis. 653.

³ Berks, etc. Turnpike Co. v. Myers, 6 S. & R. 12.

The defective execution of a mortgage by an agent who has authority to execute it, will not invalidate the mortgage when the intent is plain. Taylor v. Agricultural, etc. Ass'n. 68 Ala. 229. See also Bernards Township v. Stebbins, 109 U. S. 341, § 328.

held affected is not complied with, and he knows or is affected with notice of its non-observance. Thus, an insurance policy contained a provision that if any subsequent insurance should be made on the same property, the policy should become null and void, unless a consent to the further insurance should previously have been given in writing. The insurance agent orally consented, and the insured in good faith paid out his money in reliance thereon. A loss occurring, the court held that the company could not defend on the ground that the consent was not in writing; because such a defence would be a fraud on the insured.¹

§ 256. If after an act is irregularly done, even in a manner which would not have held the corporation, the corporation ratifies or acquiesces in the act as done, the corporation will be bound.²

Ratification.

§ 257. As provisions requiring the observance of formalities by corporate agents exist for the protection of the corporation, there is obviously no justice in allowing a party who has himself contracted with the corporate agent to plead the neglect of any formality on the part of the latter, provided the corporation has performed its side of the contract, or is ready to do so. Consequently, except when the requirement is statutory, and expressly declares that, unless it is complied with, the contract or other act shall be void, the other contracting party will not be allowed to take advantage of its non-fulfilment.³ Thus, sureties on the official bond of a cashier, conditioned for the faithful performance of his duties, will be bound, although the bond was not approved on the part of the bank in the manner required by its charter.⁴

Party contracting with corporate agent cannot plead non-observance of formalities by the latter. Sureties on official bonds.

¹ Carrugi v. Atlantic Fire Ins. Co., 40 Ga. 135. Compare Wheeler v. Smith, 9 How. 55.

² Chouteau v. Allen, 70 Mo. 290; State of Florida v. Florida Central R. Co., 15 Fla. 690.

³ Moreland v. State Bank, 1 Breese (Ill.), 263; Bates v. Bank of Alabama,

2 Ala. 451; Bond v. Central Bank, 2 Ga. 92. See Bank of South Carolina v. Hammond, 1 Rich. L. (S. C.) 281.

⁴ Bank of U. S. v. Dandridge, 12 Wheat. 64; State Bank v. Chatwood, 3 Halsted (N. J.), 1; Bostwick v. Van Voorhis, 91 N. Y. 353; see § 249, note.

§ 258. The formal requisites necessary to make the acts of the directors or trustees binding on the corporation require particular notice. Where the management of the affairs of a corporation is vested in a board of directors, the legal effect is to vest the directors with authority to act only when assembled as a board. Formalities to be observed by directors. They should act as a board. Therefore, when a claim against a corporation is based on any particular contract, alleged to have been executed by the directors (to the validity of which the assent of a quorum of the directors was necessary), it is essential that the directors should have acted as a board in executing it.¹ Accordingly, a deed executed on behalf of the corporation by all the directors acting separately, which they never authorized while acting as a board, is invalid.² And the parol declarations of individual directors are not competent evidence of an agreement to appropriate for a specific purpose a certain fund of money, which in a contract made by the directors as a board had been reserved to the use of the corporation.³

§ 259. But this rule does not invalidate a contract made with a person acting in good faith in ignorance that the directors had taken no action as a board, if the circumstances entitled him to assume that the directors had acted in the proper manner.⁴ Nor does the rule apply Exceptions.

¹ *Baldwin v. Canfield*, 26 Minn. 43; *Electric Telegraph Co.*, 40 L. J. Eq. 567. *Stoytown, etc. Turnpike Road Co. v. Craver*, 45 Pa. St. 386; *Hillyer v. Overman Silver M'g Co.*, 6 Nev. 51; *Lockwood v. Thunder Bay River Boom Co.*, 42 Mich. 536, 539; *Gashwiler v. Willis*, 33 Cal. 12; *D'Arcy v. Lamar, etc. R'y Co.*, L. R. 2 Ex. 158; S. C., 4 H. & C. 463. See *Junction R. R. Co. v. Reeve*, 15 Ind. 236; *Yellow Jacket Silver M'g Co. v. Stevenson*, 5 Nev. 224; *First Nat. Bank v. Christopher*, 40 N. J. L. 435, 437; *Despatch Line of Packets v. Bellamy M'f'g Co.*, 12 N. H. 205, 224; *Edgerly v. Emerson*, 23 N. H. 555, 567. Contra, *In re Bonelli's*

For analogous rules regarding the manner in which the managing boards of municipal and religious corporations should act, see *Cammeyer v. United German Churches*, 2 Sandf. Ch. 186; *Dey v. Jersey City*, 19 N. J. Eq. 412; *Schumm v. Seymour*, 24 N. J. Eq. 153; *Shortz v. Unangst*, 3 W. & S. 45; *German Evangelical Congregation v. Pressler*, 14 La. Ann. 811.

² *Baldwin v. Canfield*, 26 Minn. 43.

³ *Grayville and Mattoon R. R. Co. v. Burns*, 92 Ill. 302. See *East Line, etc. R. R. Co. v. Garrett*, 52 Tex. 133.

⁴ See §§ 251, 203. None of the

when the contract relied on by the person claiming to have acquired a right against the corporation, was actually made not by the directors, but by an officer deriving his authority from them. In such a case, if the assent of the majority of directors be shown to have been given in any way to the execution of the contract by the officer, or if the directors subsequently acquiesce, the corporation will not be heard to plead that the directors had never taken action as a board in the matter.¹ And even where the contract relied on was executed separately by a majority of the directors, the rule requiring them to act as a board will not apply if the contract is an ordinary contract acquiesced in for years by all the directors, and is performed on the part of the other contracting party. Thus, where a person was employed by three directors (a majority) acting separately, to render services to a bank, and he rendered services for five years, to the knowledge of all the directors, none of whom objected, it was held that the employment was binding on the bank.²

Of course, the rule cannot apply where the contract relied on by the other party is made by one or two directors having authority to make it: and how far the rule may apply to the action of directorial committees and sub-committees is questionable.

§ 260. Assuming now that the directors acting together as a board have done an act within their powers, the act will be valid, in the absence of any provision to the contrary in the constitution or by-laws of the corporation, if it is done or authorized by a majority vote of the directors present at the meeting, when there is present a majority of the total number of directors; provided the meeting was assembled either in pursuance of some provision in the constitution or by-laws, or upon due notice to all the directors. The different parts of this proposition require discussion.

In the first place, a majority of all the directors must be

cases cited in the last two notes are authority for the application of the rule under such circumstances; and see *Tenney v. East Warren Lumber Co.*, 43 N. H. 343.

¹ *Bank of Middlebury v. Rutland*, etc. R. R. Co., 30 Vt. 159; *St. James*

Parish v. Newburyport Horse R. R., 141 Mass. 500. See § 212.

² *Bradstreet v. Bank of Royalton*, 42 Vt. 128; see *Waite v. Mining Co.*, 37 Vt. 608; *Bank of New London v. Ketchum*, 64 Wis. 7.

present to constitute a quorum for the transaction of business.¹ Such being the case, a majority vote of those actually present decides, and is valid.²

Unless the meeting is one that assembles at stated times pursuant to some provision in the constitution or by-laws,³ it must be duly notified to all the directors.⁴ For, even if a majority of a total number of directors are present and the vote is unanimous, so that the votes of the absentees could not have changed the result, it does not follow that those actually present would not have voted differently had they heard what the absentees, if present, might have said. To make the proceedings regular, all should have had an opportunity to be present, and take part in them.⁵ Where there is no special provision as to the notice,

¹ In the absence of special provision, less than a majority of all the directors composing the board have no power to transact the business of the corporation. *Price v. Grand Rapids, etc. R. Co.*, 13 Ind. 58; *Stringham v. Oshkosh & M. R. R. Co.*, 33 Wis. 471; *Ex parte Willcocks*, 7 Cow. 402; 2 Kent's Com., 293; *Angell and Ames on Corp.*, §§ 501, 502.

² *Cram v. Bangor House Proprietary*, 12 Me. 354; *Despatch Line v. Bellamy M'fg Co.*, 12 N. H. 205; *Wells v. Rahway White Rubber Co.*, 19 N. J. Eq. 402; *Booker v. Young*, 13 Gratt. (Va.) 303; *Lockwood v. Mechanics' Nat. B'k*, 9 R. I. 308; *Cahill v. Kalamazoo Ins. Co.*, 2 Dougl. (Mich.) 124; *Ex parte Willcocks*, 7 Cow. 402; *Sargent v. Webster*, 18 Metc. (Mass.) 497; *Edgerly v. Emerson*, 23 N. H. 555; *Buell v. Buckingham*, 16 Iowa, 284; *Leavitt v. Oxford, etc. M. Co.*, 3 Utah, 265; 2 Kent's Com., 293. Compare *Holcombe's Ex'r v. Managers N. H. D. B. Co.*, 9 N. J. Eq. 457.

³ Of such a meeting no notice is necessary, or notice is presumed. See *Despatch Line v. Bellamy M'fg Co.*,

12 N. H. 205, 226; *Edgerly v. Emerson*, 23 N. H. 555, 567; *Angell and Ames on Corp.*, § 488.

⁴ *Gordon v. Preston*, 1 Watts, 385; *Farwell v. Houghton Copper Works*, 8 Fed. Rep. 66; *Doyle v. Mizner*, 42 Mich. 332, 341; *Kersey Oil Co. v. Oil Creek, etc. R. R. Co.*, 12 Phila. 374. Compare *Jackson v. Hampden*, 20 Me. 37. But if all the directors actually consult together, and a majority concur, it seems no notification is necessary. *Despatch Line v. Bellamy M'fg Co.*, 12 N. H. 205, 227.

⁵ In the case of *Edgerly v. Emerson*, 23 N. H. 555, it was stated "that where a quorum of the directors of a bank meet, and unite in any determination, the corporation are bound, whether the other directors are or are not notified." (23 N. H. 569.) But the court then said that the rulings of the court below on the irregularity of the meeting were immaterial to the issue; so the above statement, though arrived at after consideration, was not necessary to the decision of the case. And the proposition, thus broadly stated, it is submitted, is not law.

it should be reasonable in point of time;¹ and should be personal if the directors reside in the same place.

§ 261. As the usual presumptions in favor of regularity apply to directors' meetings, it is always to be presumed that the meeting was regular; and the burden of proof to show a want of due notice of the meeting is on the party impeaching its regularity.² Further, the recital in a resolution that notice of a meeting of the board was served on all the directors, is evidence, though not under all circumstances conclusive, of the regularity of the notice.³

Finally, although want of the service of due notice on all the directors may be pleaded by the corporation as against any person acting with knowledge of the facts;⁴ yet such omission, according to principles already stated, will not affect the rights of a person dealing with the directors on the *bona fide* and reasonable assumption that their action has been regular.⁵

§ 262. The general rules above stated regarding the notice of directors' meetings, and the number of directors necessary to concur in the acts of the board, may be modified by provisions in the constitution or by-laws of the corporation, and also, it seems, by custom.⁶ Thus, if the constitution requires the concurrence of a certain number of directors to the doing of a given action or the making of a contract, the act or contract, if not concurred in by the requisite number, will not in itself bind the corporation.⁷

¹ See *Covert v. Rogers*, 38 Mich. 363. As to the meetings of directors outside of the state, see § 381.

² *Sargent v. Webster*, 13 Metc. (Mass.) 497; *Lane v. Brainerd*, 30 Conn. 565; *Chouteau Ins. Co. v. Holmes*, 68 Mo. 601; *Levitt v. Oxford, etc. M. Co.*, 3 Utah, 265; *Budd v. Walla Walla Printing Co.*, 2 Wash. Ter. 347.

³ *Granger v. Original Empire Mill Co.*, 59 Cal. 678.

⁴ *Kersey Oil Co. v. Oil Creek, etc. R. R. Co.*, 12 Phila. 374; *Farwell v. Houghton Copper Works*, 8 Fed. Rep. 66.

⁵ See § 251. There seems no reason to doubt that the general rules stated in regard to notice and the requisite majority will ordinarily apply to the meeting of directors' committees.

⁶ Thus, it is held in England, that when the articles do not state the number of directors necessary to constitute a quorum, the number usually acting in the business of the corporation will suffice. *In re Tavistock Iron Works Co.*, *Lyster's Case*, L. R. 4 Eq. 233.

⁷ *Beatty v. Marine Ins. Co.*, 2 Johns. 109; *Ridley v. Plymouth Baking Co.*, 2 Exch. 711; see *Daws v. North River Ins. Co.*, 7 Cow. 462,

§ 263. In evidence the presumptions applicable to individuals apply to corporations;¹ and as a general rule the acts of corporations may be proved in the same manner as the acts of individuals.² Often the charter or by-laws may provide that regular records of the proceedings of the managing boards shall be kept by some designated officer. And when the record exists, the rules of evidence require its production as constituting the best evidence. But the breach of a provision requiring acts of the board to be recorded, whatever may be the effect of the omission in rendering certain officers derelict in their duties, does not impair the validity of the unrecorded acts.³

Rules of evidence applicable to corporations. Corporate books.

The books of the corporation are competent evidence to prove the number of shares subscribed for and the names of the subscribers;⁴ they are competent evidence of the meeting held to organize the corporation and of the action taken thereat.⁵ They are competent to prove the acceptance by the corpora-

overruled in *Conover v. Mutual Ins. Co.*, 3 Denio, 254; *Kirk v. Bell*, 16 Q. B. 290; *Card v. Carr*, 1 C. B. N. S. 197. But it seems where a statute prescribes the whole number of directors, and also what number shall constitute a quorum, that the quorum may act, although the whole number is deficient. *Thames Haven Dock Co. v. Rose*, 4 M. & G. 552.

¹ *Bank of the U. S. v. Dandridge*, 12 Wheat. 64. Compare *Johnson v. Bush*, 3 Barb. Ch. 207.

² *Southern Hotel Co. v. Newman*, 30 Mo. 118. Compare *Leonard v. Burlington Mut. Loan Ass'n*, 55 Iowa, 594.

³ *Bank of U. S. v. Dandridge*, 12 Wheat. 64; *Burgess v. Pue*, 2 Gill (Md.), 254; *Bank of Kentucky v. Schuylkill Bank*, 1 Parson's Sel. Cas. (Penn.) 180, 251, 263; *Trott v. Warren*, 11 Me. 227; *Cram v. Bangor House Proprietary*, 12 Me. 354; *Russell v. McLellan*, 14 Pick. 63; *Mid-*

dlex Husbandmen v. Davis, 3 Metc. (Mass.) 133; *Davidson v. Bridgeport*, 8 Conn. 472; *Schallard v. Eel River Nav. Co.*, 70 Cal. 144.

⁴ *Evans v. Bailey*, 66 Cal. 112; *Penobscot R. R. Co. v. Dummer*, 40 Me. 172; *Glenn v. Orr*, 96 N. C. 413. See, also, *Macon, etc. R. R. Co. v. Vasour*, 57 Ga. 314; *Washer v. Allensville, etc. T. P. Co.*, 81 Ind. 78; *Fox v. Allensville, etc. T. P. Co.*, 46 Ind. 31. When commissioners are provided for by statute, their books are official registers, and are admissible in evidence to prove a subscription. *Monroe v. Ft. Wayne, etc. R. R. Co.*, 28 Mich. 272.

⁵ *Duke v. Cahawba Nav. Co.*, 10 Ala. 82. See *Blake v. Griswold*, 103 N. Y. 429; *Glenn v. Orr*, 96 N. C. 413. Their competency as evidence against the corporation is not impaired by the fact that they have been in the possession of its attorneys. *McCullough v. Talladega Ins. Co.*, 46 Ala. 376.

tion of a subscription contract, though it has been held that they are not competent to prove such contract as against the subscriber.¹ They are not competent to establish a right in the corporation against an outsider.² And as to outsiders, a corporation is not bound by interpolations fraudulently inserted in its records, when such outsiders have not seen, acted on, or known of the existence of such interpolations.³ But if outsiders have acted on the faith of the records, the corporation will be estopped from alleging the falsity of interpolations fraudulently made in its books by its own secretary.⁴

¹ *Colfax Hotel Co. v. Lyon*, 69 Iowa, 683.

² *Jones v. Trustees Florence University*, 46 Ala. 626.

³ *Holden v. Hoyt*, 134 Mass. 181. See *Parker v. Nickerson*, 137 Mass. 487. The reports of officers of the corporation to the shareholders or to the board of directors, in which certain

claims for which the corporation is not bound are enumerated among its liabilities, will not bind the corporation to pay such claims, or prevent it from changing its purpose with regard to them, *Hall v. Mobile, etc. Ry. Co.*, 58 Ala. 10.

⁴ *Commonwealth v. Reading Savings Bank*, 137 Mass. 431.

PART III.

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Questions of *ultra vires*; prerequisites to the solution of them.

§ 264. So far as to responsibility for acts within the scope of the corporate powers. Very different questions arise as to whether acts beyond the corporate powers are binding and on whom. These are questions concerning the application of the doctrine of *ultra vires*, a doctrine which has at times worked hardship.¹

¹ The term *ultra vires*, like most other legal terms, has been used in more senses than one; and objections have been taken to it on the ground that so-called questions of *ultra vires*—"beyond the powers"—are not really questions of the power, but of the legal right of corporations to act. It seems proper, however, in legal writing to use words in a legal sense; and, in a legal sense, the term "power" signifies legal competence, capacity, or right. Comstock, C. J., said in *Bissell v. Michigan, etc. R. R. Cos.*, 22 N. Y. 258, 264: "Like natural persons, they [corporations] can overleap the legal and moral restraints imposed upon them; in other words, they are capable of doing wrong. To say a corporation has no right to do unauthorized acts is to put forth a very plain truism; but to say that such bodies have no power or capacity to err, is to impute to them an excellence which does not belong to any created existences with which we are ac-

quainted. The distinction between power and right is no more to be lost sight of in respect to artificial than in respect to natural persons." "Artificial persons" exist, if at all, only by virtue of law. Accordingly, it seems inconsistent to speak of their power in any other than a strictly legal sense.

The term *ultra vires* is convenient, pretty well imbedded in the law, and may be used to advantage if care is taken to apply it only in respect of corporate powers, and not in respect of the powers of corporate officers. The term, moreover, should not be used in the sense of illegal. See the dissenting opinion of Blackburn, J., in *Taylor v. Chichester and Midhurst R'y Co.*, L. R. 2 Ex. 356. As Judge Allen said, in *Whitney Arms Co. v. Barlow*, 63 N. Y. 62, 68: "When acts of corporations are spoken of as *ultra vires*, it is not intended that they are unlawful or even such as the corporation cannot perform, but merely

They are far from simple, and require for their solution the adjustment of many conflicting interests and the determination of complicated legal relations. It is submitted that these questions never can be solved so long as the old conception of a corporation as a unit, as a legal person, is retained in the discussion of them. The first prerequisite to their proper solution is to recognize that by the term "corporation" is connoted a mass of rights and liabilities subsisting as legal relations between persons whose interests in the corporate enterprise are divergent if not conflicting, and whose responsibility for any given *ultra vires* act is not always the same.¹ "In applying the doctrine of *ultra vires*, in a particular case, regard must be had not only to the unauthorized agreement or transaction, but also to the relation which the litigating parties sustain to it."² The second

those which are not within the powers conferred upon the corporation by the act of its creation, and are in violation of the trust reposed in the managing board by the shareholders, that the affairs shall be managed, and the funds applied solely for carrying out the objects for which the corporation was created." See also *Nat. Pemberton Bk. v. Porter*, 125 Mass. 333, 335. *Ins. Co.*, 35 Ohio St. 324, 337. In *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543, Sawyer, C. J., said, giving the opinion of the court: "In considering the cases in which the law applicable to corporations is discussed, it must be always borne in mind that there are several classes of rights to which they apply, and that upon the same general state of facts, the legal consequences might be different with reference to the different classes of rights. Thus they [there?] are corporate rights—that is to say, rights which pertain to corporations as such—the artificial legal entity created by the act of incorporation considered as a single distinct person; individual rights of the stockholders *as such*, and rights of the creditors of the corporation. The rights of strangers dealing with the corporation may vary as they are considered with reference to the corporation itself, the stockholders, or the creditors of the corporation." Compare *Bacon v. Robertson*, 18 How. 480.

The writer would add that the following exposition of the legal relations arising from *ultra vires* transactions is submitted with diffidence. He has found no discussion of the subject in any case or text book which has seemed satisfactory to him; and therefore can hardly expect his discussion to be satisfactory to others. The subject is certainly complicated in the extreme and full of difficulties. To reconcile what is said in the different reported cases would be impossible; but the actual decisions are on the whole harmonious and just; and the text is thought to accord with the majority of them.

¹ See Chap. III.

² *Ehrman v. Union Central Life*

prerequisite is the recognition of the principle that the constitution of a corporation, and, consequently, the corporate powers, are presumed to be known as matters of law to all persons interested in the corporate enterprise, or dealing with the corporation.¹

§ 265. The following proposition may now be submitted:

General rules. An act beyond the scope of the corporate powers, if done on behalf of a corporation, or if done by the body corporate itself, affects the rights of persons in respect of the corporate enterprise only in so far as the possessors of those rights by their own acts or omissions have estopped themselves from asserting their rights; provided the act be of such a character that the party dealing with the corporation or its agents could, from an examination of the charter, or enabling statute and articles of association, have ascertained that the act was *ultra vires*.²

¹ Davis v. Old Colony R. R., 131 Mass. 258; Relfe v. Rundle, 103 U. S. 222, 226; Salt Lake City v. Hollister, 118 U. S. 256, 263; Bohmer v. City Bank, 77 Va. 445; Leonard v. American Ins. Co., 97 Ind. 299; Haden v. Farmers', etc. Fire Ass'n, 80 Va. 683; Spence v. Mobile, etc. Ry. Co., 79 Ala. 576. This is, of course, entirely distinct from the question whether courts will take judicial notice of the powers of a corporation, which largely depends on whether the corporation is incorporated by special charter or under a general law. For courts will not take judicial notice of a special charter. Kelly v. Ala. & Cin. R. R. Co., 58 Ala. 489. "Persons dealing with the managers of a corporation must take notice of the limitations imposed upon their authority by the act of incorporation." Pearce v. Madison, etc. R. R. Co., 21 How. 441, 443. See §§ 195, 320.

² This proposition, as well as the reasoning of the following paragraphs, seems fully supported by Lucas v.

White Line Transfer Co., 70 Iowa, 541, 545-547. See also *In re* National Permanent Building Society, *Ex parte* Williamson, L.R. 5 Ch. 309; Knoxville v. Knoxville, etc. R. R. Co., 22 Fed. Rep. 758. In chap. v. of his work on "Ultra Vires," Mr. Brice states the following general propositions:—

"I. A corporation has all the capacities for engaging in transactions which are expressly given it by the constating instruments.

"II. A corporation has all the capacities for engaging in transactions which are impliedly given it from the language of the constating instruments.

"III. A corporation has all the capacities or powers for management which are given it by its constating instruments, either expressly or by reasonable inference therefrom.

"IV. Capacities or powers for management may be given by wide general language.

"V. Corporations have no capacities or powers other than those indi-

§ 266. The truth and import of this proposition may be illustrated by three series of cases, the three series respectively furnishing authorities for the three following propositions which, taken together, have the same import with the general proposition just stated.

Subordinate rules connoted by it.

(1) An act beyond the corporate powers, if done by any corporate agent, does not bind the corporation. (2) Such an act cannot be executed or ratified by a majority vote of the body corporate so as to bind the corporation. (3) But, as the different classes of persons interested ratify or acquiesce in such an act they become estopped from alleging that it was not authorized, or binding on the corporation and their interests in the corporate enterprise. A fourth series of cases will illustrate the proviso or qualification to the general proposition.

§ 267. An act beyond the scope of the corporate powers, if done by the board of directors or any other corporate agency, is not binding on the corporation; for persons dealing with a corporation through its agents are affected with notice of its powers, and cannot assume that any agent has authority to transact business which the corpo-

First subordinate rule.

cated in the four preceding propositions, and they cannot legally or validly engage in other transactions.

“VI. Courts in dealing with corporations will look to those capacities and powers only which they actually possess at the time.

“VII. Corporations cannot be rendered directly liable upon *ultra vires* transactions, but must account for benefits received therefrom.

“VIII. Special proceedings in themselves *ultra vires*, will sometimes be upheld as having been rendered necessary by unexpected circumstances.

“IX. Formalities are generally not imperative, but merely directory, and therefore the absence of them can be set up only against those persons who were cognizant of the defect.

“X. Franchises and special privileges, or powers in the nature of franchises, cannot be delegated.

“XI. Special powers of whatever description can be used only *bona fide* for the purposes for which created.

“XII. The capacities and powers of the governing body, and *a fortiori* those of the subordinate agents of the corporation cannot be greater, and will generally be much more restricted than those of the corporation.

“XIII. Any party to an *ultra vires* transaction may set up the defence thereof, and any one corporator may call upon the courts to restrain the corporation from engaging therein.”

These propositions seem not inconsistent with the statement in the text, except perhaps the first part of Proposition XIII.

ration was not authorized to engage in.¹ Accordingly, it has been held that the trustees of a savings bank, when to the knowledge of persons dealing with them there are no funds in the bank for investment, cannot bind the bank by a contract to take shares in a manufacturing corporation.² Neither can the board of directors of a national bank bind their bank by guaranteeing to a banking house issuing a letter of credit, the obligation of the person receiving the letter.³ Nor can the directors of a railroad corporation, or of a corporation organized to manufacture and sell musical instruments, bind their respective corporations by an agreement to guarantee the expenses of a musical festival.⁴

§ 268. An act beyond the corporate powers cannot validly be done by the body corporate acting as such (*i. e.*, through the vote of a majority in a duly assembled meeting), nor can it be thus ratified. For the majority have no authority by such an act or ratification to bind absent or dissentient shareholders; and persons dealing with the corporation are affected with knowledge of this.⁵ The majority cannot make a disposition of the corporate property unauthorized by the constitution of the corporation.⁶

¹ *Alexander v. Cauldwell*, 83 N. Y. 480; *Elevator Co. v. Memphis, etc. R. Co.*, 85 Tenn. 703; see *Downing v. Mount Washington Road Co.*, 40 N. H. 230.

² *Franklin Co. v. Lewiston Inst. for Savings*, 68 Me. 43; see *Wilbur v. Stockholders*, 18 Bankr. Reg. 178. So the officers of a corporation authorized to do a general insurance agency, commission, and brokerage business, cannot on its behalf subscribe to stock in a savings bank, and the bank cannot enforce the subscription. *Mutual Savings Banks v. Meriden Agency Co.*, 24 Conn. 159.

³ *Seligman v. Charlottesville Nat. Bk.*, 3 Hughes C. Ct. 647; see *Johnston v. Same, ib.* 657.

⁴ *Davis v. Old Colony R. R.*, 131 Mass. 258. See also *Lucas v. White Line Transfer Co.*, 70 Iowa, 541.

⁵ *Bird v. Bird's Patent, etc. Co., L. R.*, 9 Ch. 358.

⁶ *Kean v. Johnson*, 9 N. J. Eq. 401; *Taylor v. Earle*, 8 Hun, 1. A single dissenting shareholder may enjoin the majority from applying the corporate property to unauthorized purposes. *Natusch v. Irving*, Gow on Part. App. ii.; *Lyde v. Eastern Bengal Ry. Co.*, 36 Beav. 10; see §§ 556, 557. A shareholder in a railroad corporation may bring suit to set aside an *ultra vires* lease of the road. *Board, etc. Tippecanoe County v. Lafayette, etc. R. R. Co.*, 50 Ind. 85.

§ 269. As the different classes of persons interested in the corporate enterprise ratify or acquiesce in the unauthorized act they estop themselves from questioning its validity.

Third subordinate rule.

An *ultra vires* contract is invalid because enforcing it would injure some one's rights. If the persons whose rights would have been injured assent to the contract, it thereupon becomes valid, since thus the reasons for its invalidity cease.¹ If, however, the contract, besides being *ultra vires*, is also illegal, the rights of the public may be regarded as affected, and the assent of all the individuals especially interested in the corporate enterprise will not make the contract valid.² As Judge Folger said, giving the opinion of the New York Court of Appeals in *Kent v. Quicksilver Mining Co.*:³ "In the application of the doctrine of *ultra vires*, it is to be borne in mind that it has two phases: one where the public is concerned; one where the question is between the corporate body and the stockholders in it, or between it and its stockholders, and third parties dealing with it and through it with them. When the public is concerned to restrain a corporation within the limits of the power given to it by its charter, an assent by all the stockholders to the use of unauthorized power by the corporate body will be of no avail. When it is a question of the right of a stockholder to restrain the corporate body within its express or incidental powers, the stockholder may in many cases be denied on the ground of his express assent, or his intelligent though tacit consent to the corporate action. If there be a departure from statutory direction, which is to be considered merely a breach of trust to be restrained by a stockholder, it is pertinent to consider what has been his conduct in regard thereto. A corporation may do acts which affect the public to its harm, inasmuch as they are *per se* illegal or are *malum prohibitum*. Then no assent of stockholders can validate them. It may do acts not thus illegal, though there is want of power to do them, which affect only the interest of the stockholders. They may be made

¹ The act of incorporation furnishes no security to persons assenting to unauthorized acts. *Kearny v. Buttles*, 1 Ohio St. 362.

² The illegality of *ultra vires* acts is discussed in § 287 *et seq.*

³ 78 N. Y., 159, 185.

good by the assent of the stockholders, so that strangers to the stockholders, dealing in good faith with the corporation, will be protected in a reliance on those acts."¹

§ 270. Accordingly, if all the shareholders ratify the contract, or impliedly assent to it by not dissenting after they know of it, no shareholder can object, or claim that the contract, being beyond the corporate powers, does not bind the corporate funds; for he can make such claim only in so far as his interests are concerned, and just to that extent is he estopped by his own action.²

§ 271. It does not follow, however, that acquiescence or ratification by all the shareholders will, under all circumstances, validate for all purposes an act which, though not illegal, is *ultra vires*. Other persons besides shareholders possess direct pecuniary interests in the corporate enter-

¹ Compare *Andrews v. Union Mut. Fire Ins. Co.*, 37 Me. 256. "I think that any objection made only on the ground that it affects the interests of a shareholder, can only be made by or on behalf of the shareholders The seemingly technical point raises the question whether the smallest excess of authority renders the whole contract illegal, and so entitles those who have the management of the corporation (and who therefore presumably were, as individuals, consenting parties to the contract) to repudiate the contract in the name of the company, however long it has been acquiesced in, and however seriously the position of the plaintiff has been altered in consequence of that acquiescence, or whether the objection should be held to lie only in the mouths of those shareholders who were not consenting parties to the contract sought to be set aside, or have not by laches or otherwise rendered it inequitable in them to set it aside. It is obvious that an adherence to this distinction will prevent those scandalous cases which

have rendered the word repudiation a term of opprobrium." *Blackburn, J.*, in *Taylor v. Chichester, etc. Ry. Co.*, L. R. 2 Ex. 356, 380.

² *Branch v. Jesup*, 106 U. S. 468; *Tyrell v. Cairo, etc. R. R. Co.*, 7 Mo. App. 294; *Taylor v. S. and N. Alabama R. Co.*, 13 Fed. Rep. 152. See *Peoria and Springfield R. R. Co. v. Thompson*, 103 Ill. 187; *Kelley v. Newburyport Horse R. R.*, 141 Mass. 496. Compare *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381, a case where (*semble*) a shareholder could have restrained an act beyond the original powers of the corporation, but authorized by a statute passed subsequently to the charter. The proxy of the shareholder, however, had been present at the shareholders' meeting which ratified the act, and did not vote, when his vote in the negative would have controlled. It was held that the shareholder could not dispute the validity of the act under the circumstances, the bonds having been issued and having passed into the hands of outsiders.

prise, or at least in the continuing solvency of the corporation. These are corporate creditors. They have rights, and may not have waived them.

§ 272. Suppose, for example, that A. has made a contract with a corporation which was beyond its powers; but the contract has been ratified by all the shareholders. Illus-
tration. It may also be assumed that A. has performed his part, so that all that remains is for the corporation to pay money, or otherwise perform on its side. The corporation may be insolvent, and there may be creditors whose claims have arisen from transactions clearly within the corporate powers. If the claim of A. is satisfied, those creditors will lose part or all of the money due them. The funds of the corporation are trust funds, to be applied to the corporate objects, which are known to all; and every one contracts and is entitled to do so on the faith that these funds will be applied exclusively to these objects. The corporate objects include the discharge of liability properly contracted in their attainment; and the funds of the corporation are trust funds for this among other purposes. Under such circumstances who has the better claim to have his debt paid from the corporate funds? A., who contracted, knowing that the objects for which those funds were set apart excluded the payment of his debt? or the other creditors who contracted, knowing that the objects for which the funds were set apart included the payment of their debts? There can be no doubt that the other creditors have a far clearer right, and that by an appropriate action the payment of any money to A. may be restrained.¹

§ 273. Accordingly, it is held that as against the rights of creditors of the corporation, a contract not within the corporate powers cannot be made valid by the assent of all the shareholders, nor can it, by partial performance on the side of the person contracting with the corpora- Rights of
creditors.

¹ As between creditors of an insolvent bank, those whose debts were created under lawful power given by the charter, must be preferred to those who claim under a contract which the bank had no power to make. In such cases the bank is not estopped to set up the illegality or want of power. *Bank of Chattanooga v. Bank of Memphis*, 9 Heisk. (Tenn.) 408.

tion, become the foundation of a right of action.¹ And when a corporation has entered into an *ultra vires* contract, a claim founded thereon will be disallowed when there is a concurrence of creditors, and the corporation is insolvent in the hands of a receiver.²

Since the only interest of a creditor is that the funds of the corporation shall suffice for the payment of debts due him, and as his only right in respect of the funds is that they shall not be used, in contravention of the constitution of the corporation, in a way to imperil his interests, it follows that, should the corporation be clearly solvent and the debt due a creditor claiming under an *ultra vires* contract, but small in comparison with the resources of the corporation, the corporate creditors would have no rights which would justify the disallowance of the debt arising from the *ultra vires* contract.

§ 274. Summing up, it may be said that to hold that a contract *ultra vires* a corporation binds or affects the rights of persons who neither expressly nor impliedly have assented to it, is to hold, as to shareholders, that funds subscribed for a certain purpose in pursuance of direct authorization from the state, may, against the will of the subscribers, be applied to other purposes; is to hold, as to creditors, that funds set apart for the payment of their claims, on the faith of which they contracted and were invited to contract, may without their assent be applied to purposes other than the satisfaction of their legal claims. Such a decision disregards vested rights and impairs the obligations of a contract.

§ 275. At this point it seems well to examine a leading case on the doctrine of *ultra vires*, the opinions in which contain dicta with which it is not clear that the main proposition stated in the text³ accords. The case referred to is *Bissell v. Michigan Southern and Northern*

Opinions in
Bissell v.
Railroad
Cos.

¹ *National Trust Co. v. Miller*, 33 N. J. Eq. 155.

² *Abbott v. Balto., etc. Steam Packet Co.*, 1 Md. Ch. 542. A receiver of an insolvent corporation may repudiate a transfer of mortgages owned by the corporation, if the transfer was

made to secure the obligations of the corporation arising from an *ultra vires* transaction. *Talmage v. Pell*, 7 N. Y. 328; *Bank Commissioners v. St. Lawrence*, ib. 513.

³ § 265.

Indiana R. R. Cos.¹ In the course of an elaborate opinion, Judge Comstock said:² "I think this doctrine of theoretical perfection in corporations would convert them practically into most mischievous monsters. A bank, through its board of directors, may invest its funds in the purchase of stock, and every holder of the stock may acquiesce, expecting to profit by the speculation. If the enterprise is successful, the corporation and the shareholders gain by the result. If a depression occurs in the market, and disaster is threatened, the doctrine that a corporation can never act outside of its charter, enables it to say, 'this is not our dealing,' and the money used in the adventure may be unconditionally reclaimed from whatever parties have received it in exchange for value; while the injured dealer must seek his remedy against agents, perhaps irresponsible and unknown. Corporations may thus take all the chances of gain without incurring the hazards of loss." The shareholders who assent certainly should not be allowed to object to the contract; but suppose that the bank owes a creditor a large sum of money; if the bank pays the losses from the stock operations, this creditor will lose part of his claim. He has a better right, as before pointed out, to be paid than the creditors whose claims arise from transactions known to have been beyond the corporate powers. The inquiry should be, is there any person whose rights would be impaired by carrying out the *ultra vires* contract who is not estopped from claiming the contract to have been *ultra vires*?³

The same judge says on the same page:⁴ "In the relations of private principal and agent, the adoption of an agent's unauthorized dealing is equivalent to an original authority; and the adoption is perfect when the principal receives the proceeds of the dealing. Corporations may practically act in the same manner." Here the difficulty is that in a corporate enterprise no one has authority to ratify *ultra vires* acts so as to bind any one else, because the ratification of *ultra vires* acts is beyond

¹ 22 N. Y., 258. Approved in *of creditors were not before the court, Buffett v. Troy and Boston R. R. Co.,* and presumably the learned judge did 40 N. Y. 168. not have their rights in view.

² 22 N. Y. 264.

⁴ 22 N. Y. 264.

³ It is right to say that the interests

the scope of any agency in the directors or in the body corporate;¹ and that such ratification is beyond the scope of any agency existing in respect of the corporate enterprise, every one dealing with the corporation is held to know.

The only point actually decided in this celebrated case, was that two corporations, created respectively by the states of Michigan and Indiana, with power to each to build and operate a railroad within the state granting the charter, having united in the business of transporting passengers over a third railroad in the state of Illinois, beyond the limits authorized by the charter of either, are jointly liable for injuries to a passenger resulting from the negligence of their employes, occurring in the state of Illinois. The *decision* is unobjectionable, for the shareholders must have known of the operations in Illinois, and, not having objected to them, they would have been estopped from objecting to the results; and no suggestion was made to the court that the payment of the comparatively small sum of twenty-five hundred dollars, the amount of damages found by the jury, would prejudice the rights of creditors.

§ 276. The rules which this case and sundry others in New York² and elsewhere have tended to establish, may be considered here. If the corporation has performed the contract on its side, the other contracting party cannot plead *ultra vires* when latter has performed. *Arms Co. v. Barlow*,³ and even in the absence of all

¹ The notion of a body corporate ordinarily connotes the right of a majority to act for all. But the right of a majority to act for all does not extend beyond the purposes of organization. See *Pickering v. Stephenson*, L. R. 14 Eq. 322, 340.

² *E. g.*, *Parish v. Wheeler*, 22 N. Y. 494.

³ 63 N. Y., 62; *Accord National Bank v. Whitney*, 103 U. S. 99; *Union Water Co. v. Murphy's Flat Fluming Co.*, 22 Cal. 621; *Hall M'fg Co. v. American, etc. Supply Co.*, 48

Mich. 331; *Franklin Ave. German S'v'gs Inst. v. Board of Education*, 75 Mo. 408; *Oil Creek, etc. R. R. Co. v. Penna. Trans'n Co.*, 83 Pa. St. 160; *Goundie v. Northampton Water Co.*, 7 Pa. St. 233; *Leazure v. Hillegas*, 7 S. & R. 313; *Leavitt v. Pell*, 27 Barb. 322; *Steam Nav. Co. v. Weed*, 17 Barb. 378; *Germantown Farmers' Mut. Ins. Co. v. Dhein*, 43 Wis. 420; *Edwards v. Fairbanks*, 27 La. Ann. 449; *Allen v. Freedman's Savings Co.*, 14 Fla. 418; *Brown v. Mortgage Co.*, 110 Ill. 235; *Chicago & A. Ry.*

authority would seem clear. "One who has received from a corporation the full consideration of his engagement to pay money . . . cannot avail himself of the objection that the contract thus fully performed by the corporation was *ultra vires*, and not within its chartered privileges and powers."¹ Such a person, having himself made the contract and received its benefit, is clearly estopped from making any such allegation.²

§ 277. The converse of this proposition is also said to be law. If the other contracting party has performed his side of the contract, the corporation cannot plead that its charter gave it no power to enter into the contract; at least if the corporate property has been benefited by the performance. It is submitted that this last proposition involves a fallacy. If the other contracting party had contracted through an agent whose instructions were contained in a written instrument which the corporation knew to contain all the authority which the agent possessed; and if the contract in question was unauthorized by this instrument, could any one

Converse of this proposition involves a fallacy.

Co. v. Derkes, 103 Ind. 520; Chester Glass Co. v. Dewey, 16 Mass. 94; Union Nat. Bank v. Hunt, 76 Mo. 439. See Goodin v. Evans, 18 Ohio St. 150; Goodin v. Cincinnati, etc. Canal Co., ib. 169; Kelly v. People's Transportation Co., 3 Oregon, 189; Shewalter v. Pirner, 55 Mo. 218; Third Avenue Savings Bank v. Dimock, 24 N. J. Eq. 26; Dutchess Cotton Manufactory v. Davis, 14 Johns. 238, 245; Reynolds v. Crawfordsville First Nat. B'k, 112 U. S. 405, 413. Contra, Chambers v. Falkner, 65 Ala. 449; compare Screven Hose Co. v. Philpot, 53 Ga. 625; Mut. Benefit Life Ins. Co. v. Davis, 12 N. Y. 569; North River Ins. Co. v. Lawrence, 3 Wend. 482; Beach v. Fulton Bank, 3 Wend. 573.

Regarding contracts forbidden by statute, see §§ 297 *et seq.*

¹ Whitney Arms Co. v. Barlow, 63 N. Y. 70.

² As long as the corporation has not performed its side of the contract, there might be great hardship in disallowing the plea of *ultra vires* to the other contracting party; as he might have no assurance that the corporation would perform on its side. See Simpson v. Building Ass'n, 38 Ohio St. 349; and compare Railroad Co. v. Telegraph Co., ib. 31. Accordingly, it is held that an *ultra vires* contract, as long as it remains executory on both sides, cannot be enforced by the corporation, at least if the contract be such that public policy forbids the corporation to make it. Nassau Bank v. Jones, 95 N. Y. 115. The contract was for the purchase by a bank of shares in a railroad corporation. See also Wilkes v. Pacific R. R. Co., 79 Ala. 180; Day v. Spiral Springs Buggy Co., 57 Mich. 146.

maintain that the principal would be bound *because* the corporation had performed its side of the contract? Yet, in reality, it is in analogy with this to hold the corporation bound *because* the other contracting party has performed.¹

§ 278. To illustrate, let us imagine that B. is a land-owner, A. his agent, and C. a manufacturer of fertilizers. If C., knowing that A. has no authority from B. to purchase fertilizers, sells a large amount of them to be applied on B.'s lands, and they are so applied, but without B.'s knowledge, C. has executed the contract on his side, and B.'s lands have had the benefit. Yet it is clear that C. has no valid claim against B. Apply this to the case of a corporation. Let B. be the shareholders and creditors; let A. be the board of directors, and C. the other contracting party. A. makes a contract with C. beyond the powers of the corporation—beyond A.'s powers to represent the corporate interests. In legal intendment C. knows this contract to be beyond A.'s authority, but nevertheless performs his side of it, and the results of his performance are applied to the benefit of the corporate enterprise, but without the knowledge of the shareholders or creditors. Here the interests of shareholders and creditors have been benefited; but through no voluntary action or acquiescence on their part, and through acts which C. knew they had not authorized. It is again clear that C. by his performance acquires no rights which can affect the interests of shareholders and creditors. And the same reasoning would apply even if the corporation by a vote in corporate meeting ratified the contract; the rights of absent or dissentient shareholders would not thereby be affected, provided they were guilty of no laches in asserting their rights. Undoubtedly, if the shareholders know that *ultra vires* contracts are being entered into and per-

¹ To be sure the principal could not disavow the unauthorized portion of a contract, and hold the other contracting party with respect to the rest. And on similar principles, when the agent of a corporation has purchased for it certain chattels, and given back a purchase-money mortgage thereon, the en-

forcement of the mortgage cannot be enjoined on the ground that the mortgage was *ultra vires*. *Amerman v. Wiles*, 24 N. J. Eq. 13; see *Parish v. Wheeler*, 22 N. Y. 494; *Whitney v. Leominster Savings Bank*, 141 Mass. 85. See §§ 310-312.

formed, and that the proceeds are being applied to the corporate enterprise, they cannot with honesty stand quietly by, but must do all in their power to prevent such application. Therefore through acquiescence after they know, or, if they had been at all observant of corporate affairs, would have known of the contracts, they would be estopped from objecting. And so perhaps might creditors estop themselves.

The preceding argument leads to this unavoidable conclusion: the mere facts that the other contracting party has executed his side of the *ultra vires* contract, and that the corporate property has thereby been benefited, do not affect the rights of persons who have done nothing from which assent to the contract can in any way be inferred.¹

§ 279. If one examines with care the cases which are regarded as authority for this alleged general rule that sounds so just—if the other contracting party has performed, and by his performance benefited the property of the corporation, the latter cannot plead *ultra vires*—it will appear that the recovery of the other party really does not rest on the fact that he has performed, nor on the fact that his performance has benefited the corporate property: though undoubtedly he would not have had the same cause of action had he not performed; and that corporate interests were benefited may very likely have been a material point in establishing his case. It is submitted, that in these cases the plaintiff's recovery rests on the circumstance that all the persons who would have been entitled to object to the contract, allowed the plaintiff to go on and perform under the reasonable assumption on his part of general acquiescence in the contract. To be sure, shareholders are not generally supposed to be continually exercising an active supervision over the affairs of the corporation. But they have a right to inspect its books, and, if they choose, may keep themselves acquainted with what is being done by the corporate management. At any rate, unless they keep a watch over the course of the corporate affairs, they will not be entitled on the

Examination of certain cases.

¹ This reasoning accords as fully as a person cannot by his own act acquire the proposition controverted disaccords a right against another; the other must with a most universal principle of law; in some way have bound himself.

plea of their own ignorance to come forward at their pleasure and cause the repudiation of corporate obligations. Shareholders wishing to prevent illegal or *ultra vires* acts, or to absolve the corporation from responsibility for them, must be vigilant and swift.¹

§ 280. Take, for instance, the leading case of *Bissell v. Railroad Companies*,² on which this alleged rule is said to rest. In the first place not all the judges who concurred in the result based their decision on that rule at all; and in the second place, it would have been preposterous not to assume that all the shareholders were acquainted with the fact that the corporations were running a railroad where their charters did not authorize them to run one. Or take the leading Illinois case often referred to as establishing this rule, *Bradley v. Ballard*.³ There a shareholder sought to restrain the prosecution of a suit against the corporation brought to recover on an *ultra vires* contract, which had been performed by the plaintiff in the suit against the corporation. But the shareholder seeking the injunction was also a director, and, as the court said, had been willing enough that the contracts should be made as long as he expected profits to arise from them.⁴ So in other Illinois cases more or less based

¹ *Thompson v. Lambert*, 44 Iowa, 239. "A court of equity may refuse to interfere with a corporation at the instance of a stockholder, in respect to an unauthorized contract which has been fully executed, when if the same stockholder had applied in season for an order to restrain the execution of the contract, equity might have felt bound to grant the relief prayed for. Especially is this so where the complainant has stood by and allowed the illegal transaction to be consummated, and has allowed and induced others to become interested in the corporation on the supposition that the existing state of things is legal and proper." *Terry v. Eagle Lock Co.*, 47 Conn. 141, 161.

² § 275.

³ 55 Ill., 413.

⁴ 55 Ill., 419. For instance, it has been held that the holder of a note for value may enforce it against the maker, a corporation, although it was *ultra vires* the corporation to purchase the property in payment for which the note was given, and the holder knew the consideration of the note. The defendant retained the property, and did not offer to give it up. *Wright v. Pipe Line Co.*, 101 Pa. St. 204. The note was given to pay for stock purchased by defendant in contravention of a statutory prohibition. Court said this was a matter for the attorney-general. But see, *semble contra*, *Westinghouse Machine Co. v. Wilkinson*, 79 Ala. 312.

on *Bradley v. Ballard*, but in which the corporation itself resisted the suit on the plea of *ultra vires*, it is evident that the decisions proceed on the assumption, and there was no suggestion to the contrary, that the contracts sued on, and the transactions in the course of which the contracts were performed, had been generally acquiesced in.¹

*Darst v. Gale*² is another case frequently cited in support of the alleged rule—which is indeed stated in so many words in the opinion of the court—“that a private corporation cannot avail of the defence of *ultra vires* where the contract has been in good faith fully performed by the other party, and the corporation has had the benefit of the contract and the performance.” But in this case the defence was not set up by or on behalf of the corporation, nor on behalf of any person interested in it. A subsequent grantee of premises belonging to the corporation attempted to have a prior deed of trust covering the same property set aside, on the ground that such deed was *ultra vires* the corporation; he having bought with full notice of the prior deed. The *ultra vires* nature of the prior deed had infringed no right of his; and, consequently, he had no standing in court to interpose the plea of *ultra vires*.

§ 281. The decision, if not the reasoning, in this case, points to an important principle respecting the plea of *ultra vires*. As we have seen, the plea cannot be interposed by the party contracting with the corporation when the corporation has performed:³ and the reason for this lies not only in the estoppel with which, under the circumstances, such a person is affected, but in the following reason as well: That the transaction was *ultra*

Ultra vires
cannot be
pleaded by
a person
whose
rights are
not in-
fringed.

¹ *Peoria and Springfield R. R. Co. v. Thompson*, 103 Ill. 187; *Ward v. Johnson*, 95 Ill. 215. It is thought that the foregoing remarks will generally apply to cases relied on in support of this alleged rule, in some of which, indeed, the rule is stated in so many words. See *Oil Creek, etc. R. R. Co. v. Penna. Trans'n Co.*, 83 Pa. St. 160; *State Board of Agriculture v. Citizens' Street R'y Co.*, 47 Ind. 407.

Compare *Arnot v. Erie R'y Co.*, 67 N. Y. 315; *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381; *Main v. Casserly*, 67 Cal. 127.

² 83 Ill., 136. Compare *Grant v. Henry Clay Coal Co.*, 80 Pa. St. 208. And for the validity of unauthorized conveyances of real or personal property to a corporation, see § 303.

³ § 276.

vires infringed none of his rights; he cannot, therefore, interpose the defence. There is a plain principle which is not only law, but patent common sense. With a few special exceptions, no one can represent another before the courts or elsewhere, without authority, express or implied, to do so. To an action brought against himself, a man cannot ordinarily plead that the rights of another, whom he is not authorized to represent, will be affected by the prosecution of the suit. If the court consider that hardship and injustice will result, unless the interests of such outside person are regarded, the court—at least a court of equity—may require him to be made a party to the suit, in order to afford him opportunity to protect his interests. Accordingly, when a contract *ultra vires* a corporation is entered into, it is not competent for persons whose rights are not infringed, any more than for those who by their actions have estopped themselves from complaining, to restrain the fulfilment of the contract on the ground that the interests of others, which they are not authorized to represent, will be injured. It may therefore be stated as a rule, that a person whose rights are in no way infringed by the fact that a given act is *ultra vires* a corporation, can found no action or defence on that fact.¹

§ 282. There are a number of decisions in accord with this rule. Thus, a corporation incorporated “for the purpose of manufacturing fabrics of wool and worsted or of a mixture thereof with other textile materials,” may maintain an action against the purchaser of groceries sold by a person who was keeping a store as the undisclosed agent of the corporation.² On similar principles it is held that when a corporation has, in an unauthorized manner, purchased a note, its title thereto

¹ Compare *Wherry v. Hale*, 77 Mo. 20; *Farmers’, etc. Bank v. Detroit*, etc. R. R. Co., 17 Wis. 372; *St. Louis Drug Co. v. Robinson*, 81 Mo. 18.

A release executed by a contracting party to a corporation (a county) of his rights relating to the unfulfilled portion of an *ultra vires* contract, the release being executed at the request

of defendant who had a personal interest in getting the contract discharged, is a good consideration to support a promise made by the defendant to the party executing the release. *Wile v. Wilson*, 93 N. Y. 255.

² *Slater Woolen Co. v. Lamb*, 143 Mass. 420.

cannot be questioned by the promisor.¹ Nor can irregularities in a mortgage made by a corporation be taken advantage of by a subsequent grantee of the mortgaged premises.² Likewise, the power of a corporation to assign a chose in action cannot be questioned in an action thereon by the assignee;³ and although the purchase of a piece of land may have been *ultra vires* a railroad company, still, when the railroad company sells the land the title of its vendee is good.⁴ Again, when both plaintiff and defendant claim under a common source,—from a railroad corporation,—the plaintiff by conveyance at an execution sale of its property, the defendant under deeds of trust executed by it, neither can set up that the acquisition of the property was *ultra vires* the corporation.⁵ And, finally, where the president with other officers of a corporation bought stock for the company, and subsequently converted it unlawfully to their own use, they cannot plead when sued for the conversion, that the original purchase made by them on behalf of the corporation was *ultra vires*.⁶

§ 283. Still, however clear it may be that in order to do adequate and accurate justice in regard to legal relations arising from *ultra vires* transactions, the rights of the different persons and classes of persons interested in the corporate enterprise must be adjudicated upon as distinguishable, it must be admitted that courts often seem to have disregarded these distinctions, apparently viewing the corporation as a unit, like the person dealing with it; and it must also be admitted that the rule disapproved of in the text is generally regarded as law.⁷ Undoubtedly it will be often impossible to allow a contract to be repudiated by shareholders who have never assented to it and who in justice should be allowed to repudiate it, without at the same time relieving consenting shareholders from the burden of a contract they have assented to, from which there

¹ Ehrman v. Union Cent. Life Ins. Co., 35 Ohio St. 324.

⁵ Morgan v. Donovan, 58 Ala. 241.

² Beecher v. Marquette, etc. Mill Co., 45 Mich. 103; Darst v. Gale, ante, § 280.

⁶ St. Louis Stoneware Co. v. Partidge, 8 Mo. App. 217.

³ Small v. C. R. I. and P. R. R. Co., 55 Iowa, 582.

⁷ It was recently held the correct rule in Camden and A. R. R. Co. v. Mays Landing, etc. R. R. Co., 48 N. J. L. 530. See also Denver Fire Ins. Co. v. McClelland, 9 Col. 11.

⁴ Walsh v. Barton, 24 O. St. 28.

is no justice in relieving them. The truth seems to be that corporation law has not reached the stage of development where exact justice may be done in all such cases.¹

§ 284. We come now to consider the qualification to the general rule stated above.² The rule that neither the officers of a corporation, nor the body corporate itself, can bind dissenting shareholders or creditors by *ultra vires* contracts, is mainly based on the fundamental principle of corporation law, that all persons dealing with the corporation or its agents are affected with notice of the corporate powers as indicated by the corporate constitution. It is accordingly evident, that, the main reason for the rule failing, the rule does not apply to contracts apparently within the corporate powers, but in reality *ultra vires* on account of extraneous facts. A person dealing with a corporation may assume that acts done on its behalf are proper; and circumstances especially within the knowledge of the corporate representative will not ordinarily affect the rights of such a person acting in good faith.³ Accordingly, if an act done by a corporate agent, or by the body corporate, be apparently within the scope of the corporate powers, the rights of the party dealing with the corporation or its agent will not be affected by the circum-

¹ It has often been said and held, that a corporation from the fact that it has entered into a contract is not estopped from denying its competency to make it, when sued thereon. (*E. g.*, *Pennsylvania, etc. Nav. Co. v. Dandridge*, 8 Gill & J. (Md.) 248.) In this proposition it is probable that the word "corporation" is used by the court in two senses: one as meaning the directors or other persons, who on behalf of the body corporate, actually made the contract; the other as the body corporate itself, or all the shareholders. Likewise it is very likely that in the ordinary proposition—if the party who has contracted with the corporation has performed his side of the contract, the corporation is estopped from pleading *ultra vires*—the

word "corporation" will be used in two senses as well.

Moreover, such loose statements ignore the difference in the positions, regarding an *ultra vires* transaction, occupied by consenting shareholders and by those who dissent. Courts sometimes make remarks like the following: "The plea of *ultra vires* should not, as a general rule, prevail, whether interposed for or against a corporation, when it would not advance justice, but, on the contrary, would accomplish a legal wrong." *Rider Life Raft Co. v. Roach*, 97 N. Y. 378, 381. Opinion of court per MILLER, J.—simply an identical proposition stated hesitatingly.

² § 265.

³ § 203.

stance that the act in question was rendered *ultra vires* either by extraneous facts, or by the secret purpose of the corporation or its agent respecting the act; provided the party acted in good faith and as a careful man.¹

§ 285. This principle is particularly applicable to negotiable instruments issued by a corporation. A negotiable corporate security, which upon its face appears to have been duly issued in conformity with the corporate constitution, is valid in the hands of a *bona fide* holder for value without notice, although the security was in fact issued for a purpose and at a place not authorized by the corporate constitution.² If the agent had power to issue a corporate security for any purpose, any one receiving it in the ordinary course of business is justified in assuming that it was properly issued.³ Under this principle, moreover, accommodation indorsements and certifications of banks, which may be beyond the bank's powers, will bind the bank in favor of any *bona fide* holder for value without notice of the character of the indorsement or certification.⁴

Negotiable
instru-
ments.

§ 286. The application of this principle, however, is not restricted to negotiable instruments. If a corporation borrows money or purchases property, having the power to do so, the rights of the lender or vendor will not be affected by the circumstance, unknown to him, that the money is borrowed or the property purchased for an unauthorized purpose.⁵ Accordingly, if a person sells to a

Further ap-
plication of
the qualifi-
cation.

¹ See *Express Co. v. Railroad Co.*, 99 U. S. 191, 199; *Charleston, etc. Turnpike Co. v. Willey*, 16 Ind. 34.

² *Stoney v. American Life Ins. Co.*, 11 Paige, 635; *Galveston Railroad v. Cowdrey*, 11 Wall. 459; *Alexander v. Rollins*, 84 Mo. 657; *Lehigh Valley Coal Co. v. Agricultural Works*, 63 Wis. 45. See also *Safford v. Wyc-koff*, 4 Hill, 442; *Main v. Casserly*, 67 Cal. 127; and §§ 203, 204.

³ *Genesee Savings Bank v. Michigan Baye Co.*, 52 Mich. 438. Railroad companies have a general power

to make contracts and borrow money, and persons dealing in securities issued by them may, in the absence of notice to the contrary, assume that restrictions upon this power have not been violated. *Ellsworth v. St. Louis, etc. R. R. Co.*, 98 N. Y. 553. See §§ 205, 328.

⁴ *National Bank v. Young*, 41 N. J. Eq. 531. See §§ 242-244.

⁵ See *Thompson v. Lambert*, 44 Iowa, 239; *Oxford Iron Co. v. Spradley*, 51 Ala. 171; and §§ 204-207.

"If the contract is *ultra vires* with

corporation such property, real or personal, as it is authorized to purchase, he is under no obligation to inform himself whether, under the circumstances, the particular purchase was proper for the corporation to make.¹ Indeed, it is held that even if the vendor of goods or the lender of money to a corporation knows that the goods are bought or the money borrowed to be used for some unauthorized or even illegal purpose, he may still recover the price or the loan; provided it was no part of his contract that the goods or money were to be used for that purpose, and provided, also, that he has done nothing to further the unlawful design.² The principle referred to also covers cases where a corporation, authorized to borrow money to a certain amount, borrows in excess. If a person lends money to it in ignorance that the limit has been already reached, he will be entitled to recover.³ And finally under this principle arises the obvious distinction between the exercise by a corporation of a power not possessed by it and in no way incidental to the objects of its incorporation, as set forth in its constitution of which every one must take notice; and the abuse of a general power possessed by the corporation, or the failure to comply with prescribed formalities in exercising its powers, when such abuse or failure is not known to the other contracting party.⁴

the knowledge of the party making it, he cannot afterwards enforce it; but if he has no such knowledge, it would be binding in his favor." *Eastern Counties R'y Co. v. Hawkes*, 5 H. L. C. 331, 338, per Lord Campbell.

¹ *Eastern Counties Railway Co. v. Hawkes*, 5 H. L. C. 331. See *Cowell v. Springs Co.*, 100 U. S. 55; *Natoma Water and M'g Co. v. Clarkin*, 14 Cal. 544, 552; *Moss v. Rossie Lead M'g Co.*, 5 Hill, 137.

² *Tracy v. Talmage*, 14 N. Y. 162; and see cases in the last note, and § 293. This last proposition may be questionable. Very likely it would and should hold when goods are sold directly to a principal, the vendor knowing that they will be put to some

illegal use. But suppose the vendor knows that an agent, to whom he is selling the goods, is going to use them in some way not authorized by the principal, or is going to embezzle them: should the vendor then be allowed to recover against the principal, *e. g.*, a corporation?

³ *Humphrey v. Patrons' Mercantile Ass'n*, 50 Iowa, 607; *Auerbach v. Le Sueur Mill Co.*, 28 Minn. 291; *Ossipee M'f'g Co. v. Canney*, 54 N. H. 295; *Connecticut River S'v'gs Bk. v. Fiske*, 60 N. H. 363. (A suit against a shareholder.) See §§ 127, 205.

⁴ See *Davis v. Old Colony Railroad*, 131 Mass. 258, 260; *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381, 398; *Haynes v. Covington*, 21

§ 287. The discussion has so far ignored all question of the illegality of *ultra vires* contracts, proceeding rather on the assumption that a contract is not illegal in any proper sense of that term merely because made by or on behalf of a corporation not authorized to make it.¹

The illegality of *ultra vires* acts.

An invalid contract is one which does not bring the parties to it within the operation of the contemplated rules of law, and so fails to occasion the desired legal relations. An illegal contract is an invalid contract which is such because some rule of law forbids it to be made. Invalid contracts, which are not illegal, can usually be validated; but illegal contracts cannot ordinarily be validated. If A. orders a set of tools of B. at a price exceeding fifty dollars, and no money is paid down and no note or memorandum in writing made, the contract will be invalid under the Statute of Frauds; but will be capable of subsequent validation on complying with the terms of that statute. On the other hand, if the tools happen to be counterfeiters' dies, the contract is illegal and incapable of subsequent validation, because of the law against possessing or manufacturing such instruments. Again, if a contract is made on behalf of A. by B., who has no authority to represent him, the contract will not bring A. within the operation of rules of law which will manifest themselves in liabilities on his part; that is to say, the contract will not bind him, and in that respect will be invalid; but no one would call such a contract illegal.

§ 288. We have seen that corporate funds are set apart for certain purposes from which no one has authority to divert them so as to impair the legally protected interests of any per-

Miss. 408; *City Fire Ins. Co. v. Car-rugi*, 41 Ga. 660, 673; *Screven Hose Co. v. Philpot*, 53 Ga. 625. A corporation authorized to loan for one year on bond and mortgage may foreclose a mortgage given to secure a note for a debt running two years. *Germantown Farmers' Mut. Ins. Co. v. Dhein*, 43 Wis. 420.

¹ "The words *ultra vires* and illegality represent totally different and

distinct ideas." Comstock, C. J., in *Bissell v. Mich. S. and N. I. Railroad Cos.*, 22 N. Y. 258, 269. "There is a manifest distinction between cases arising under contracts which are contrary to public policy or *mala in se* or *mala prohibita*, and those which are claimed to be *ultra vires* alone." *Woodruff v. Erie Railway Co.*, 93 N. Y. 609, 618. Opin. of Ct. per Ruger, C. J. See § 264, note.

son.¹ Accordingly, if the persons having the management of these funds make a contract respecting them, whereby they would be diverted from the objects for which they are set apart, such contract would be invalid in this respect, that it would not bind the rights of dissenting shareholders or creditors. These restrictions, however, on the powers of the managers of these funds, on the powers, that is to say, of the corporate agents and of the body corporate itself, exist mainly for the security of the subscribers of the funds and of those who may deal with the corporation on the credit of them. If, then, the persons for whose security these restrictions exist, authorize or acquiesce in a diversion of the funds from the objects to which they are restricted, no one remains who can object to transactions in disregard of these restrictions. Such transactions are not illegal, for illegal means unlawful or forbidden by law; these transactions were merely unauthorized in that certain persons could have restrained the corporation from engaging in them.²

§ 289. It may be objected, that to restrain corporations within the scope of the purposes of incorporation is clearly defined public policy; that any contract contrary to public policy is illegal; therefore, contracts *ultra vires* a corporation are illegal. This requires consideration.

An argument based on public policy is at best vague and unsatisfactory. If the courts are to give weight to such arguments, in most cases they will have to determine for themselves what public policy is in regard to the question before them; and, to a great extent, they will have to base their decision on their notion of what public policy should be.³ Consequently, in their deliberations they will have to weigh the same considerations that a legislative body weighs in considering the advisability of a law, and their decision will likely amount to the creation of a new legal proposition. To determine what public policy is, is the province of the legislature;⁴ and if acts,

¹ §§ 32, 33.

² See *Kent v. Quicksilver M'g Co.*, 78 N. Y. 159, § 269; and *Vermont & C. R. R. Co. v. Vermont Central R. R. Co.*, 34 Vt. 2, 47.

³ For *ex hypothesi* as it were, public policy is what it should be.

⁴ "This court can know nothing of public policy, except from the constitution and the laws, and the course of

which would have been unobjectionable if done by individuals on their own behalf, are done by or on behalf of a corporation, are courts to declare such acts illegal merely because unauthorized by the constitution of the corporation, when the state in its discretion may at any time interfere and restrain their commission or forfeit the franchises of the corporation? Shall the court of its own motion, or at the suggestion of an individual, declare illegal and void as against public policy the very act which the exponent of public policy at any time may have annulled, and yet refrains from interfering with? By refraining from bringing an action to restrain the commission of such acts, or to forfeit the franchises of the corporation as a penalty for their commission, the state seems impliedly to admit that they are not illegal as against public policy.

§ 290. In a case referred to before, *Bissell v. Railroad Companies*, Chief Judge Comstock said:¹ "But is it true that all contracts of corporations, for purposes not embraced in their charters, are illegal in the appropriate sense of that term? This proposition I must deny. Undoubtedly such engagements may have the vices which sometimes infect the contracts of individuals. They may involve a *malum in se* or a *malum prohibitum*, and may be void for any cause which would avoid the contract of a natural person. But where no such vices exist, the only defect is one of power,² the contract cannot be void because it is illegal or immoral.

"So a church corporation may deal in exchange. This, although *ultra vires*, is not illegal, because dealing in exchange is, in itself, a lawful business, and there is no state policy in restraint of that business." It must be admitted that the last statement of the learned judge contains a *petitio principii*; for the question is not whether the business of exchange is lawful,

administration and decision. It has no legislative power. It cannot amend or modify any legislative act. It cannot examine questions as expedient or inexpedient, as politic or impolitic. Considerations of that sort must, in general, be addressed to the legisla-

ture." Chase, C. J., in *License Tax Cases*, 5 Wall. 462, 469.

¹ 22 N. Y., 269-270.

² Quære, whether the use of this word here is consistent with the remarks of the same learned judge on the distinction between "power" and "right," quoted in § 264, note?

but whether it is lawful for a church corporation to carry it on. Again, the learned judge says: "The illegality of an act is determined in its quality, and does not depend on the person or being which performs it." This seems rather a hasty generalization, for assuredly it would not be legal for an unauthorized person to execute the sentence of the law on a condemned felon, even at the time, place, and in the manner ordered for the hanging. Moreover, in the same case, Judge Selden makes a remark not in accordance with the expressions of the chief judge: "Although the authorized contract may be neither *malum in se*, nor *malum prohibitum*, but, on the contrary, may be for some benevolent or worthy object, as to build an almshouse or a college . . . yet, if it is a violation of public policy for corporations to exercise powers which have never been granted to them, such contracts, notwithstanding their praiseworthy nature, are illegal and void."¹

§ 291. A leading English case, in regard to the illegality of *ultra vires* acts, is *East Anglian Railway Company v. Eastern Counties Railway Company*;² a case which is still law in England, though parts of the opinion of the court have been unfavorably commented on. The following passages are from the opinion of Jervis, C. J.: "It is clear that the defendants have a limited authority only, and are a corporation only for the purpose of making and maintaining the railway sanctioned by the act; and that their funds can only be applied for the purposes directed by the statute. . . . Every proprietor, when he takes shares, has a right to expect that the conditions upon which the act was obtained will be performed, and it is no sufficient answer to a shareholder expecting his dividend, that the money has been expended upon an undertaking, which, at some remote period, may prove highly beneficial to the line. *The public also has an interest in the proper administration of the powers conferred by the act.* . . .

¹ 22 N. Y., 285. Just as Judge Comstock had done, Judge Selden decided in favor of the plaintiff, but on a different ground. He held that as the contract for transportation was *ultra vires*, no action would lie on it;

but that the plaintiff could recover on the ground of tort. See § 335 *et seq.*, as to liability for the torts of corporations.

² 11 C. B., 775.

If the contract is illegal, as being contrary to the act of parliament, it is unnecessary to consider the effect of dissentient shareholders, for if the company is a corporation only for a limited purpose, and a contract like that under discussion is not within their authority, the assent of all the shareholders to such a contract, though it may make them all personally liable to perform such contract, would not bind them in their corporate capacity, or render liable their corporate funds."

It is submitted, however, that the law is not as clearly stated in this case as in some of the following citations, and that passages in the opinion of the court may be open to the following criticism in a remark of Justice Blackburn in *Taylor v. Chichester and Midhurst Railway Company*:¹ "I think it very unfortunate that the same phrase of '*ultra vires*' has been used to express both an excess of authority as against the shareholders, and the doing of an act illegal as being *malum prohibitum*, for the two things are substantially different, and I think the use of the same phrase for both has produced confusion."²

From the following citations it would seem to be the better opinion in England that an act which is *ultra vires* in the sense of unauthorized, is not necessarily illegal; but that to render it so it must be *ultra vires*, meaning by the term that which is forbidden expressly or by implication.³

"Where a corporation is created by an act of parliament for particular purposes, with special powers . . . their deed, though under their corporate seal, does not bind them if it appear by the express provisions of the statute creating the corporation, or by necessary or reasonable inference from its enactments, that the deed was *ultra vires*, that is, that the legislature meant that such a deed should not be made."⁴ As used by Baron Parke, the phrase *ultra vires* means *forbidden* at least by implication, as is shown by the last line in the citation just made, as well as by the following citation from the opinion of the same learned

¹ L. R. 2 Ex., 356, 379.

² See remark of Vice-Chancellor Kindersley, in *Shrewsbury v. North Staffordshire Ry. Co.*, 35 L. J. Ch. 156, 172.

³ This last meaning is not the one in

which the term is used by the present writer, § 264, note.

⁴ Baron Parke in *South Yorkshire Ry. Co. v. Great Northern Ry. Co.*, 9 Ex. 55, 84.

judge when Lord Wensleydale, in *Scottish North Eastern Railway Co. v. Stewart*:¹ "There can be no doubt that a corporation is fully capable of binding itself by any contract under its common seal in England, without it in Scotland, except when the statute by which it is created or regulated expressly or by necessary implication prohibits such contract between the parties. *Prima facie* all its contracts are valid, and it lies on those who impeach any contract to make out that it is avoided. This is the doctrine of *ultra vires*, and is no doubt sound law, though the application of it to the points of each particular case has not always been satisfactory to my mind."

Within its scope the following is also a satisfactory statement of the law. "If a contract made by a company incorporated by act of parliament for defined and limited objects, discloses on the face of it a covenant which, if enforced, would cause the funds to be appropriated to purposes other than those to which the act says they shall 'only' be applied, such an agreement cannot be made the foundation of an action. In the case of railway companies it is necessary not only for the shareholders, but for the public, that this should be so."²

§ 292. In our American jurisprudence clear lines of distinction may be drawn between acts of corporations which are merely *ultra vires*, and acts which, besides being *ultra vires*, are for some reason unlawful. The latter may be divided into three classes: First, acts immoral in themselves, as *contra bonos mores*; secondly, acts which corporations are forbidden to do by some statutory provision; and, thirdly, acts which on grounds of public policy corporations intrusted with the performance of a public trust or duty are held prohibited from doing.

¹ 3 Macqueen, 382, 415.

² Montague Smith, J., in *Taylor v. Chichester, etc. Ry. Co.*, L. R. 2 Ex. 356, 370. This case will repay careful reading, not omitting the dissenting opinion of Judge Blackburn. It was reversed in the House of Lords, L. R., 4 H. L. 628. See also espe-

cially the later authoritative exposition of the doctrine of *ultra vires* in *Ashbury Railway Carriage, etc. Co. v. Riche*, L. R., 7 H. L. 653; § 296; and compare *Yorkshire Railway Wagon Co. v. Maclure*, 21 Ch. Div. 309.

§ 293. Acts of the first class, by common law principles, are branded as *mala in se*; or are prohibited by statute, and thereby become *mala prohibita*. To them applies the maxim, *Ex turpe causa non oritur actio*. Accordingly, a contract containing an immoral object, or a contract of which the consideration is immoral, is illegal, and may be avoided by either party. Such a contract a court will never lend itself to enforce. Thus, an agreement to pay a certain sum for obtaining the passage of a law in a state legislature is void;¹ as is an agreement for contingent compensation for procuring a contract to furnish supplies to the government.² So a bill of exchange drawn in one state upon a party in another, the known and common purpose of both parties being to carry on a business of private banking, declared unlawful by a statute of the first state, is void in the hands of a party to the bill with notice of its true character.³

It is essential, however, that the illegality should inhere in the very act or contract sought to be declared illegal.⁴ Accordingly, it is no defence to a suit for a debt; that it arose from the receipt of the bills of a bank illegally chartered for fraudulent purposes, and that the bills were void in law, and finally proved worthless in fact.⁵ Moreover, it is held that the mere knowledge of the one party that the other is going to use the proceeds of the contract for some illegal purpose, will not render the contract void, as against the party who does not himself participate in the illegal undertaking.⁶ Thus, knowledge on the part of a bank lending money that it is to be used to carry out a contract to supply arms to the Confederate government, will not prevent the bank from recovering the loan.⁷

¹ Marshall v. Baltimore and Ohio R. R. Co., 16 How. 314.

² Tool Co. v. Norris, 2 Wall. 45.

³ Davidson v. Lanier, 4 Wall. 448. Compare People v. Utica Ins. Co., 15 Johns. (N. Y.) 358.

⁴ See Nat. Pemberton Bk. v. Porter, 125 Mass. 333; Atlas Nat. Bk. v. Savery, 127 Mass. 75; Attleborough Nat. Bk. v. Rogers, 125 Mass. 339.

⁵ Orchard v. Hughes, 1 Wall. 73.

The bills themselves were actually current at the time when the defendant received them, and did not prove worthless in his hands; nor had he been forced to take them back from persons to whom he had paid them.

⁶ Tracy v. Talmage, 14 N. Y. 162; § 286.

⁷ Jones v. Planters' Bank, 9 Heisk. (Tenn.) 455; Bank of Tennessee v. Cummings, ib. 465.

Second
class. Acts
forbidden
by statute.

§ 294. Secondly, as to the effect of a statutory prohibition, forbidding the doing of certain acts by corporations.

General
prohibi-
tions.

§ 295. To general prohibitions against the doing by corporations of acts beyond the scope of the corporate powers courts appear to give little effect.

And this perhaps on account of the hardship that might arise from giving full effect to such statutes. There exists in New York, for instance, the following statute: "In addition to the powers enumerated in the first section of this title, and to those expressly given in its charter, or in the act under which it is or shall be incorporated, no corporation shall possess or exercise any corporate powers, except such as shall be necessary to the exercise of powers so enumerated and given."¹ To this statute the New York courts give little effect, construing it as merely declaratory of the common law.² The New Jersey courts, however, have held a very similar statute, which they regard as declaring the public policy of that state, to render illegal and void any contract beyond the scope of the corporate powers.³

§ 296. The English companies' act of 1862⁴ contains the following provision: "Any company limited by shares may so far modify the conditions contained in its memorandum of association, if authorized to do so by its regulations as originally framed, or as altered by special resolution in manner hereinafter mentioned, as to increase its capital by the issue of new shares of such amount as it thinks expedient, or to consolidate and divide its capital into shares of larger amount than its existing shares, or to convert its paid-up shares into stock; but, save as aforesaid, and save as is hereinafter provided in the case of a change of name, no alteration shall be made by any company in the conditions contained in its memorandum of association."⁵ One of the conditions required by this act to be stated is "the objects for which the proposed company is to be established."⁶ In view of these statutory provi-

¹ 2 N. Y. Rev. Stat., 7th ed., 1530.

³ *Morris and Essex R. R. Co. v.*

² See *Curtis v. Leavitt*, 15 N. Y. 9,
54; *Halsted v. Mayor, etc. of New*
York, 3 N. Y. 430, 433.

Sussex R. R. Co., 20 N. J. Eq. 542.

⁴ 25 and 26 Vict. c. 89.

⁵ § 12.

⁶ § 8.

sions, it was held in *Ashbury Railway Carriage and Iron Co. v. Riche*,¹ that a contract not included in the memorandum of association could not be enforced against the company, even if the whole body of shareholders had assented to it.²

§ 297. To formulate a rule by which may be determined the effect of a statutory prohibition contained in the constitution of a corporation on the validity of acts thereby forbidden is most difficult. Undoubtedly the intention of the legislature is to be followed by the courts:³ but how determine that intention? With diffidence the following rule is submitted:⁴ If a statute expressly forbids a corporation to make a certain contract, the contract is void, even though not expressly declared to be so, and is incapable of ratification; and that the contract is void as unlawful, may be pleaded by any one to an action founded directly and exclusively on the contract: unless (1) the statute expressly states what the consequences of violating it shall be, and those consequences are other than that the contract is void; or (2) the statutory prohibition was evidently imposed for the protection of a certain class of persons who alone may take advantage of it; or (3) to adjudge the contract void and incapable of forming the basis of a right of action would clearly frustrate the evident purposes of the prohibition itself.

Effect of
statutory
prohibi-
tions.
Rule.

§ 298. The rule just stated may be illustrated by decisions. First, as to the body of the rule; the prohibited contract is void, and its illegality may be pleaded by any one to an action

¹ L. R. 7 H. L. 653.

³ See *Harris v. Runnells*, 12 How.

² Lord Cairns said he did not wish to consider such a contract illegal, but as "*extra vires* and wholly null and void," and incapable of ratification. (L. R., 7 H. L. 673.) But whether or not the contract should be called illegal, the court certainly construed the statute as prohibiting it; and, consequently, the contract was contrary to law. The shadowy distinctions drawn by Lord Cairns in his opinion are difficult to comprehend.

79.

⁴ Forbidden acts will of course be *ultra vires* the corporation; and in that respect their validity will depend on principles heretofore stated. Here this is not the point under consideration; but whether, and in what respect, the illegality of the act may be taken advantage of even by those persons who, had the act not been forbidden, might not have been in a position to complain of it?

founded directly and exclusively on the contract itself.¹ If the charter of a bank forbids the bank to take more than a certain rate of interest, a note taken by it in violation of this prohibition is void ; even though the statute does not expressly declare void contracts in which a rate of interest greater than allowed is stipulated for.² So if a statute prohibits banks from issuing or circulating any bill or note that is not payable on demand without interest, notes issued in contravention of it are illegal and void, even in the hands of a *bona fide* purchaser for value.³ And when a

Illustrations. Body of the rule. Excessive rate of interest.

¹ *Barton v. Port Jackson, etc. Plank Road Co.*, 17 Barb. 397 ; *Sibell v. Remsen*, 33 N. Y. 95 ; *Franklin Bank v. Commercial Bank*, 36 Ohio St. 350. The Roman law states the principle thus : "Nullum enim pactum, nullam conventionem, nullum contractum inter eos videri volumus subsecutum, qui contrahunt lege contrahere prohibente." Codex, I. 14, lex 5.

² *Bank of U. S. v. Owens*, 2 Pet. 527 ; *Bank of Salina v. Alvord*, 31 N. Y. 473 ; *Bank of Chillicothe v. Swayne*, 8 Ohio, 257 ; *Kilbreth v. Bates*, 38 Ohio St. 187 ; *Miami Exporting Co. v. Clark*, 13 Ohio, 1 ; *Orr v. Lacey*, 2 Dougl. (Mich.) 230. See *Hitchcock's Heirs v. United States Bank*, 7 Ala. 386, 434. If, however, the usury laws of the state do not render usurious contracts void, courts in construing provisions in the constitution of a corporation which prohibit taking more than a given rate of interest, may follow the analogy of the construction put on the usury laws. *Philadelphia Loan Co. v. Towner*, 13 Conn. 249 ; *Commercial Bank v. Nolan*, 8 Miss. 508 ; *Planters' Bank v. Sharp*, 12 Miss. 75 ; *Grand Gulf Bank v. Archer*, 16 Miss. 151 ; *Larwell v. Hanover Savings Fund Society*, 40

Ohio St. 244. In the absence of special legislative exception corporations are embraced in usury statutes just as persons, and may plead usury. *Commissioners of Craven v. Atlantic & N. C. R. R. Co.*, 77 N. C. 289. The penalties of the usury laws apply to the acts of corporations done without the state ; *e. g.*, when suit is brought within the home state on a note taken by the corporation outside of the home state, and this although the laws of the state where the contract was made authorized the rate of interest stipulated for. *Ewing v. Toledo S'v'gs Bk.*, 43 O. St. 31. See *Farmers and Traders' Bank v. Harrison*, 57 Mo. 503 ; *Perkins v. Watson*, 2 Baxt. (Tenn.) 173. Compare *Buckingham v. McLean*, 13 How. 151 ; *Bank of United States v. Waggener*, 9 Pet. 378.

³ *Leavitt v. Palmer*, 3 N. Y. 19 ; *Root v. Godard*, 3 McLean, 102 ; *Hayden v. Davis*, *ib.* 276 ; *Weed v. Snow*, *ib.* 265 ; *Root v. Wallace*, 4 McLean, 8 ; *Davis v. Bank of River Raisin*, *ib.* 387. See *Western Bank v. Mills*, 7 Cush. 539 ; *Mills v. Western Bank*, 10 Cush. 22 ; compare *Faneuil Hall Bank v. Bank of Brighton*, 16 Gray, 534.

corporation without banking powers discounts a note in direct violation of a statute, it cannot recover on the note.¹

§ 299. Next, as to the first qualification of the general rule: the forbidden contract will not be void if the statute which the contract violates specifies the consequences of its violation, and those consequences are other than that the contract is void and incapable of forming the basis of an action. As was said in *Pratt v. Short*:² "A prohibitory statute may itself point out the consequences of its violation, and if, on a consideration of the whole statute, it appears that the legislature intended to define such consequences, and to exclude any other penalty or forfeiture than such as is declared in the statute itself, no other will be enforced, and if an action can be maintained on the transaction of which the prohibited transaction was a part without sanctioning the illegality, such action will be entertained."³ In this case the statute declared that "no incorporated company, without being authorized by law, shall employ any part of its effects, or be in any way interested in any fund that shall be employed for the purpose of receiving deposits, making discounts, or issuing notes, or other evidences of debt, to be loaned or put in circulation as money." And it further declared that all notes or other securities for the payment of money "made or given to secure the payment of any money loaned or discounted by any incorporated company, contrary to the provisions of the [statute], shall be void." The court held the notes or securities so taken to be void, but that the money loaned on them could be recovered.⁴

First qualification.

Second qualification.

§ 300. The second qualification to the general rule is that the contract will not be absolutely void when the prohibition exists plainly for the protection of a certain class of persons, who alone may take advantage of it.

¹ *New York State Loan and Trust Co. v. Helmer*, 77 N. Y. 64; *In re Jaycox*, 12 Blatchf. 209; *Utica Ins. Co. v. Scott*, 19 Johns. 1. See *Pratt v. Short*, 79 N. Y. 437.

² 79 N. Y. 437, 445.

³ See *Robinson v. Bland*, 2 Burr. 1077; *Lister v. Howard Bank*, 23 Md. 558.

⁴ See also *Utica Ins. Co. v. Kip*, 8 Cow. 20; *Same v. Cadwell*, 3 Wend. 296. Compare *Life, etc. Ins. Co. v. Mech. Fire Ins. Co.*, 7 Wend. 31; *New Hope Delaware Bridge Co. v. Poughkeepsie Silk Co.*, 25 Wend. 648; *Tracy v. Talmage*, 14 N. Y. 162, 189; *Curtis v. Leavitt*, 15 N. Y. 98.

As Judge Cooley said, in *Beecher v. Marquette and Pacific Rolling Mill Co.*,¹ "Courts often speak of acts and contracts as void, when they mean no more than that some party concerned has a right to avoid them. Legislators sometimes use language with equal want of exact accuracy; and when they say that some act or contract shall not be of any force or effect, mean perhaps no more than this: that at the option of those for whose benefit the provision was made it shall be voidable, and have no force or effect as against his interests."² . . . If it is apparent that an act is prohibited and declared void on grounds of general policy, we must suppose the legislative intent to be that it shall be void to all intents; while if the manifest intent is to give protection to determinate individuals who are *sui juris*, the purpose is sufficiently accomplished if they are given the liberty of avoiding it."³

§ 301. Finally, as to the third qualification, the contract will not be held void and incapable of constituting the basis of an action, if to do so would frustrate the manifest intent of the statute. The National Banking Act provides that "the total liabilities to any association of any person . . . shall at no time exceed one-tenth of the amount of the capital stock of such association actually paid in." In view of this section the Supreme Court of the United States holds that a defendant sued by a national bank for moneys loaned him cannot plead that in making him the loan the bank violated this provision.⁴ "We do not think that public policy requires, or that Congress intended that an excess of loans beyond the proportion specified should enable the borrower to avoid the payment of the money actually received by him. This would be to injure the interests of creditors, stockholders, and all who have an interest in the safety and prosperity of the bank."⁵

Third qualification.
Excessive loans by national banks.

¹ 45 Mich., 103, 108.

² See *Green v. Kemp*, 13 Mass. 515.

³ Compare *Johnson v. Underhill*, 52 N. Y. 203; *Greenpoint Sugar Co. v. Whitin*, 69 N. Y. 328; *Paulding v. Chrome Steel Co.*, 94 N. Y. 334, § 185.

⁴ *Gold Mining Co. v. National Bank*, 96 U. S. 640.

⁵ 96 U. S. 642, followed in *Duncomb v. New York, H. and N. R. R. Co.*, 84 N. Y. 190. See *Union Gold M'g Co. v. Rocky Mt. Nat. Bank*, 2 Col. 248; *Allen v. First Nat. Bank*, 23 Ohio St. 97.

In another instance where a statute provided that savings banks should make no loans on the security of names alone, it was held that the statute should not be construed so as to defeat its own purpose, and that a loan made by a savings bank in contravention of it could be recovered, and the security given (a note) enforced.¹ Again, a provision in the charter of a bank prohibiting any director or other officer, under penalty of fine or imprisonment, from borrowing money from the bank, does not exempt a director from liability for money loaned to him in violation of the prohibition;² and a corporation can retain negotiable securities given at the time to secure the repayment of such a loan, but belonging to an innocent *cestui que trust* for whom the borrower was trustee; the corporation having no notice of the trust.³

§ 302. The last-mentioned qualification, that an act will not be held void when to hold it so would frustrate the intention of the statutory prohibition, is of common application where the prohibition is not express, but arises by clear implication from the language of the charter or enabling statute of the corporation. Here the leading authority is *National Bank v. Matthews*,⁴ which decided that real estate security taken by a national bank for a loan made at the time is not void, although by implication national banks are clearly forbidden to loan money on such security. As Justice Swayne said, giving the opinion of the court: "The object of the restrictions was obviously threefold. It was to keep the capital of the banks flowing in the daily channels of commerce, to deter them from embarking in hazardous real estate speculations, and to prevent the accumulation of large masses of such property in their hands, to be held, as it were, in mortmain. The intent, not the letter of the statute, constitutes the law. A court of equity is always reluctant in the last degree to make a decree which will effect a forfeiture."⁵

¹ *Farmington Savings Bank v. Fall*, 71 Me. 49. A corporation authorized to loan on *bond* and mortgage may recover a debt secured by a *promissory note* and mortgage. *National Bank v. Insurance Co.*, 41 O. St. 1.

² *Lester v. Howard Bank*, 33 Md.

558; *Bowditch v. New England Life Ins. Co.*, 141 Mass. 292; see *Richmond Bank v. Robinson*, 42 Me. 589.

³ *Bowditch v. New England Life Ins. Co.*, 141 Mass. 292.

⁴ 98 U. S. 621.

⁵ 98 U. S. 626.

Prohibitions by implication.

" The statute does not declare such a security void. It is silent upon the subject. If Congress so meant, it would have been easy to say so, and it is hardly to be believed that this would not have been done, instead of leaving the question to be settled by the uncertain result of litigation and judicial decision. Where usurious interest is contracted for, a forfeiture is prescribed and explicitly defined."¹

" We cannot believe it was meant that stockholders, and perhaps depositors and other creditors, should be punished and the borrower rewarded, by giving success to this defence wherever the offensive fact shall occur. The impending danger of judgment of ouster and dissolution was, we think, the check, and none other contemplated by Congress."² Accordingly, a national bank may enforce against a mortgagee, and parties claiming under him with notice, a mortgage of lands executed to it as collateral security for his then existing as well as his future indebtedness. An objection to taking such a mortgage as security for future advances can be urged only by the United States.³

§ 303. It is in accordance with this reasoning that a deed of real estate to a national bank, or other corporation, rendered

¹ Ib. 627.

² Ib. 629. This case was followed in *Graham v. National Bank*, 32 N. J. Eq. 804; *Thornton v. Nat. Exch. Bk.*, 71 Mo. 221; *Winton v. Little*, 94 Pa. St. 64 (overruling previous Pennsylvania decisions); *Oldham v. First Nat. Bk.*, 85 N. C. 240. Compare *Silver Lake Bank v. North*, 4 Johns. Ch. 370.

³ *National Bank v. Whitney*, 103 U. S. 99. Acc. *Fortier v. New Orleans Nat. B'k*, 112 U. S. 439. Followed in *Simons v. First Nat. B'k*, 93 N. Y. 269. See *Reynolds v. Crawfordsville First Nat. B'k*, 112 U. S. 405; *Wherry v. Hale*, 77 Mo. 20. The following cases, in so far as inconsistent with *Nat. Bk. v. Matthews*, and *Nat. Bk. v. Whitney*, are not authority. *Crocker v. Whitney*, 71 N. Y. 161

(reversed in *Nat. Bk. v. Whitney*); *Fridley v. Bowen*, 87 Ill. 151.

A note secured by mortgage on real estate was assigned by a state bank to the national bank organized as its successor; *held*, that the national bank could foreclose the mortgage. *Scofield v. State Nat. Bk.*, 9 Neb. 316. A national bank which purchases a promissory note from an indorsee may maintain an action thereon against a prior party thereto, without regard to whether the purchase was one the national bank was authorized to make. *Nat. Pemberton Bk. v. Porter*, 125 Mass. 333; *Atlas Nat. Bk. v. Savery*, 127 Mass. 75; see *Attleborough Nat. Bk. v. Rogers*, 125 Mass. 339; *Merchants' Nat. B'k v. Hanson*, 33 Minn. 40, overruling *First Nat. B'k v. Pierston*, 24 Minn. 140.

incompetent by its charter or enabling act to hold the real estate conveyed, is not void, but voidable only at the suit of the government; for to make such conveyances void would work the greatest hardship and uncertainty of title in subsequent purchasers, and all purposes of public policy are amply subserved by holding the deed voidable at the suit of the government.¹ The same applies to unauthorized conveyances of personal property to a corporation.²

Unauthorized conveyances of real estate to corporations.

§ 304. We proceed now to consider the third of the three general classes into which *ultra vires* acts which are also illegal were divided;³ *i. e.*, those acts which, though neither immoral in themselves, nor forbidden by statute, certain corporations cannot do for reasons of public policy.

Third class of illegal *ultra vires* acts. Corporations with public duties.

When in order to accomplish objects in which the welfare of the public is deeply concerned, a corporation is organized, and powers and privileges are granted to it which would be unconstitutional for the state to grant for private objects, any act of a contractual nature that the corporation attempts to do, which, if done, would render the corporation incapable of fulfilling the purposes of its incorporation, as contemplated

¹ National Bank *v.* Matthews, 98 U. S. 621, 628; Mapes *v.* Scott, 94 Ill. 379; Warner *v.* De Witt County Nat. Bank, 4 Ill. App. 305; Leazure *v.* Hillegas, 7 S. & R. 313; Goundie *v.* Northampton Water Co., 7 Pa. St. 233; Runyan *v.* Coster, 14 Pet. 122; The Banks *v.* Poitiaux, 3 Rand. (Va.) 136; Kelly *v.* People's Trans'n Co., 3 Oreg. 189; C. B. and Q. R. Co. *v.* Lewis, 53 Iowa, 101; Barrow *v.* Nashville, etc. T. C., 9 Humph. (Tenn.) 304; Mallett *v.* Simpson, 94 N. C. 37; Barnes *v.* Suddard, 117 Ill. 237. See Grant *v.* Henry Clay Coal Co., 80 Pa. St. 208. Compare Fairfax's Devisee *v.* Hunter's Lessee, 7 Cranch, 604; Madison Ave. Bap. Church *v.* Oliver St. Bap. Church, 73 N. Y. 82.

Contra, Theveatt *v.* Bank of Hopkinsville, 81 Ky. 1.

After a corporation that has the power to hold land has made a purchase, the collateral question whether it was a violation of the charter for it to receive the conveyance, cannot be raised in a suit in ejectment by the corporation. Shewalter *v.* Pirner, 55 Mo. 218; Land *v.* Coffman, 50 Mo. 243; Chambers *v.* St. Louis, 29 Mo. 576. Compare Coleman *v.* San Rafael Turnpike Co., 49 Cal. 517; City of Natchez *v.* Mallery, 54 Miss. 499; see § 276.

² Edwards *v.* Fairbanks, 27 La. Ann. 449; compare Parish *v.* Wheeler, 22 N. Y. 494.

³ § 292.

in its constitution, is illegal and void.¹ Such acts are void because repugnant to the public welfare, and therefore against public policy. Under such circumstances public policy is pretty clearly defined, and in order to determine it a court will hardly have to deliberate as a legislative assembly. It is a public policy already pointed out by the legislature. For instance, certain persons are incorporated to build and operate a railroad, and the right to take land by compulsory process is given them; a right which it would be unconstitutional to grant for a private purpose. By such an act of incorporation the legislature plainly indicates its view that the welfare of the public demands the building and operation of such a railroad as directed in the charter, and impliedly asserts that any act, as a transfer of the road, which would render impracticable the carrying out of the provisions in the charter in the manner prescribed, is contrary to public policy.

§ 305. The grounds on which acts of this nature are held illegal and void, are clearly stated by Justice Miller in *Thomas v. The Railroad Company*:² “When a corporation, like a railroad company, has granted to it by charter a franchise intended in large measure to be exercised for the public good, the due performance of those functions being the consideration of the public grant, any contract which disables the corporation from performing those functions, which undertakes, without the consent of the state, to transfer to others the rights and powers conferred by the charter, and to relieve the grantees of the burdens which it imposes, is a violation of the contract with the state, and is void as against public policy.”³ Accordingly, in the absence of express authority, a

Transfer of
franchises.

¹ *Gulf, etc. Ry. Co. v. Morris*, 67 Tex. 692. A contract whereby a street railroad company transfers to an individual for his private use, the practically exclusive use of its tracks is void as against public policy. The right to construct and operate a street railroad is a franchise which must have its source in the sovereign power; and it is a franchise which the legislature can grant only for the public benefit,

and not for private use. *Fanning v. Osborn*, 102 N. Y. 441. In *Sapp v. Northern Central Ry. Co.*, 51 Md 115, it was held that an easement of a private right of way could not be acquired against a railroad company by prescription; for prescription presupposes a grant, and a railroad company could not grant such an easement.

² 101 U. S. 71.

³ See also *Peoria and Rock I. R'y*

corporation like a railroad or canal company, with public duties to perform, cannot lease or transfer its franchises to another corporation or an individual;¹ nor mortgage its franchises;² nor consolidate with another corporation.³

Co. v. Coal Valley M'g Co., 68 Ill. 489; *New Orleans, etc. R. R. Co. v. Delamore*, 34 La. Ann. 1225; *Pierce v. Emery*, 32 N. H. 484; *Singleton v. Southwestern R. R.*, 70 Ga. 464; *McGregor v. Dover and Deal R'y*, 17 Jur. 21; *Chambers v. Manchester, etc. R'y Co.*, 5 Best & Sm. 588; *In re National Permanent Building Society, Ex parte Williamson*, L. R. 5 Ch. 309; *London, Brighton, etc. R'y Co. v. London and S. W. R'y Co.*, 5 Jur. N. S. 801; also, *East Anglian Railway Co. v. Eastern Counties Railway Co.*, § 291.

¹ *Thomas v. Railroad Co.*, 101 U. S. 71; *Black v. Delaware and Raritan Canal Co.*, 24 N. J. Eq. 456; *Middlesex R. R. Co. v. Boston, etc. R. R. Co.*, 115 Mass. 347; *Abbott v. Johnstown, etc. Horse R. R. Co.*, 80 N. Y. 27; *Troy and Boston R. R. Co. v. Boston Hoosac Tunnel, etc. R. R. Co.*, 86 N. Y. 107; *Stewart's Appeal*, 56 Pa. St. 413; *Wood v. Bedford, etc. R. R. Co.*, 8 Phila. 94;

Board, etc. Tippecanoe County v. Lafayette, M. and B. R. R. Co., 50 Ind. 85; *American Union Tel. Co. v. Union Pac. R'y Co.*, 1 McCrary, 188; *Pittsburgh & C. R. R. Co. v. Bedford, etc. R. R. Co.*, 81* Pa. St. 104; *Archer v. Terre Haute, etc. R. R. Co.*, 102 Ill. 493, 502; *State v. Consolidation Coal Co.*, 46 Md. 1; *Winch v. Birkenhead, etc. R'y Co.*, 5 De G. & Sm. 562.

Authority to consolidate and connect with a road of a foreign corporation is not authority to lease to that corporation. *Archer v. Terre Haute and I. R. R. Co.*, 102 Ill. 493. Authority given by statute to one railroad company to buy the road of another, is authority to the latter company to sell. *New York & N. E. R. R. Co. v. New York, etc. R. R. Co.*, 52 Conn. 274. Compare *State v. Consolidation Coal Co.*, 46 Md. 1. See § 420.

Authority in the charter of a telegraph company to lease its line, fixtures, and apparatus, does not author-

² *Richardson v. Sibley*, 11 Allen, 65; *Commonwealth v. Smith*, 10 Allen, 448; *Daniels v. Hart*, 118 Mass. 543. See *Richards v. Merri-mack, etc. R. R. Co.*, 44 N. H. 127; see *State v. Sherman*, 22 Ohio St. 411, 428. Authority to a railroad company to mortgage its "road, income, and other property" does not authorize a mortgage of its franchises. *Pullan v. Cincinnati, etc. Air Line R. R. Co.*, 4 Biss. 35. As to what has been construed as authority to a railroad com-

pany to sell or mortgage its road, see *Branch v. Jesup*, 106 U. S. 468.

It has been held that a railroad company, expressly authorized to borrow, has implied power to mortgage its road and its right to build and use the same; though the court said it "could not (they supposed) mortgage its corporate existence or any other prerogative franchise." *Bardstown & L. R. R. Co. v. Metcalfe*, 4 Metc. (Ky.) 199.

³ *Pearce v. Madison, etc. R. R. Co.*, 21 How. 441.

The Federal Supreme Court has recently laid down the following rules regarding the incapacity of railroad companies to lease their roads: "Unless specially authorized by its charter, or aided by some other legislative action, a railroad company cannot, by lease or any other contract, turn over to another company, for a long period of time, its road and all its appurtenances, the use of its franchises, and the exercise of its powers, nor can any other railroad company without similar authority make a contract to receive and operate such road, franchises, and property of the first corporation, and such a contract is not among the ordinary powers of a railroad company, and is not to be presumed from the usual grant of powers in a railroad charter."¹ The court further held that an unauthorized lease of a railroad could be repudiated by the corporation in excess of whose powers it was made, although the road had been operated under it for a number of years; and that a contract by another corporation guaranteeing such an *ultra vires* lease was also void.²

The above views are well supported by authority and probably state the law correctly. Yet in the United States it would be difficult to find a railroad company that has not mortgaged its road and franchises, and in most instances under express legislative authority. And perhaps the majority of railroad companies either lease their own roads or hold leases of the roads of other companies. The words of Chief Justice Ruler,

ize a lease of its franchises, and a lease of its franchises is void. *Philadelphia v. Western Union Tel. Co.*, 11 Phila. 327.

A railroad company cannot escape the performance of any duty or obligation imposed by its charter or the general law, by a voluntary surrender of its road into the hands of lessees; and the corporation remains liable for injuries occurring when its road is being run jointly by its receiver and its lessees. *Railroad Co. v. Brown*, 17 Wall. 445; *Whitney v. Atlantic, etc. R. R. Co.*, 44 Me. 362; *Wyman v. Penobscot,*

etc. R. R. Co., 46 Me. 162; *York and Maryland Line R. R. Co. v. Winans*, 17 How. 30. See §§ 131, 132, 170.

¹ *Pennsylvania R. R. Co. v. St. Louis, etc. R. R. Co.*, 118 U. S. 290, 309. Opinion of the court per Miller, J. These statements were not *dicta*.

² *Ib. Bradley and Harlan, JJ.*, dissented. It was held, however, in *Camden & A. R. R. Co. v. Mays Landing, etc. R. R. Co.*, 48 N. J. L. 530, that the lessee could not plead to an action for rent due under a lease that the lease was beyond its powers. See the following note.

giving the opinion of the New York Court of Appeals in *Woodruff v. Erie Railway Co.*, seem more in accord with present railroad customs and the tendency of legislation: "Whatever may be the rule in other states or in England, the public policy of this state, as manifested by numerous acts of the legislature, has always been, not only to afford the fullest scope for the consolidation and reorganization of non-competing railroads and railroad corporations, but also for the transfer of the use of such roads and their franchises by one corporation to another."¹

In regard to corporations with public duties to perform, questions of *ultra vires* and illegality are apt to run into each other. In chartering a corporation of this character, the legislature may be presumed to have in view mainly the interests of the public; and may further be presumed to express in the charter or enabling act the legislative conception of what is and what is not conducive to the public interests. Accordingly, an act done by such a corporation which is plainly unauthorized by its constitution may readily be held by the courts to be illegal and void as against public policy.² Nevertheless, corporations with public duties to discharge, like other corpo-

¹ 93 N. Y. 609, 618. Accord with this remark *Vermont & C. R. R. Co. v. Vermont Central R. R. Co.*, 34 Vt. 2, 49; *Shepley v. Atlantic, etc. R. R. Co.*, 55 Me. 395, 407. The point decided in *Woodruff v. Erie Railway Co.* was that the lessee of a railroad could not plead that the lease was *ultra vires* the lessor company. See the preceding note.

² It is not, however, against public policy for a railroad corporation to agree to do what it possesses no power to do, provided the agreement be conditioned on its receiving the requisite authority from the legislature. Thus, it has been held that a corporation may agree to extend its road provided certain outsiders, representing business interests along the line of such

proposed extension, will secure the requisite authority from the legislature. "It was in substance an agreement to do something not at that time legal, but which the passing of an expected statute would render legal; and both parties must have understood that, if the sanction of the legislature should be withheld, the contract would not go into effect. The contract does not import that plaintiffs bound themselves to construct the road at all events and without legislative authority." *New Haven and Northampton Co. v. Hayden*, 107 Mass. 525. See also *Supervisors v. Wisconsin Central R. R.*, 121 Mass. 460; and compare *Burbank v. Jefferson City Gas Light Co.*, 35 La. Ann. 444. See § 162 a.

rations, have undoubtedly all powers and capacities necessary or incidental to the accomplishment of the objects of their incorporation and the successful carrying out of their business.

§ 306. That such corporations can do no act which does or may disable them from serving the public as it was intended they should serve it; and that, therefore, they cannot without special authority transfer or mortgage their franchises, or the property which is necessary to enable them to use their franchises, seems settled. But in regard to many contracts and arrangements made by railroad companies, the rights of the public are to be considered; and, while the vague statement may be made, that if any such contract infringes the rights of the public it will be void as against public policy, every one knows that public rights and public policy are not easily ascertainable; and just what view a court will take of any given contract, counsel may find difficult to prognosticate.

§ 307. The various traffic and business arrangements of railroads may now be considered; but, beforehand, a general rule may be submitted that seems fairly deducible from the decisions and sound as far as it goes.

A business or traffic arrangement or contract entered into by a railroad or other corporation charged with the performance of public duties, that is fairly necessary, incidental, or ancillary to the carrying out of its purposes of incorporation, will be valid (assuming the contract to be entered into in the proper manner), provided the contract is not injurious to the public (1) by necessarily or potentially rendering the corporation incapable of performing its public duties or enabling it to shirk its public obligations, or (2) by creating an undue monopoly in the contracting parties, through the stifling of competition or in other ways, or (3) by giving exclusive or unfair advantages to certain individuals over the general public.

§ 308. It is in accordance with this rule, and is generally accepted law, that railroad companies may make contracts with passengers and shippers for carriage beyond their own lines;¹ and in order to fulfil such contracts, may make suitable arrangements with con-

Other acts.
Traffic arrangements.
Carriers' contracts to carry beyond their lines.

¹ For authorities see § 362.

necting lines of railroad and steamboat,¹ including contracts whereby passenger fares and freights are divided between the connecting companies in certain proportions.² When a railroad company does more than make an ordinary contract with a connecting line for the transportation of passengers and merchandise and a division of receipts, and contracts to give the other company control or extensive running powers over its road, such a contract may be of questionable validity in view of the rule forbidding railroad companies to transfer their franchises or put it out of their power to serve the public as it was intended they should serve it; namely, through their own corporate management, and not by handing their property and franchises over to another corporation.³ Accordingly, it would seem that a contract whereby one railroad company gives up all practical control over its own road, and in effect leases it to the other company, would be void.⁴ Besides, the other com-

¹ *Stewart v. Erie and Western Trans'n Co.*, 17 Minn. 372; *Wiggins Ferry Co. v. Chicago and Alton R. R. Co.*, 73 Mo. 389; *Munhall v. Pennsylvania R. R. Co.*, 92 Pa. St. 150; see *Green Bay and Minn. R. R. Co. v. Union Steamboat Co.*, 107 U. S. 98; *Arnot v. Erie R'y Co.*, 5 Hun, 608; *Buffet v. Troy and B. R. R. Co.*, 40 N. Y. 168; *Parish v. Wheeler*, 22 N. Y. 494; *Wheeler v. San Francisco and A. R. Co.*, 31 Cal. 46; *Rutland and B. R. R. Co. v. Proctor*, 29 Vt. 93; *Shawmut Bank v. Plattsburgh, etc. R. R. Co.*, 31 Vt. 491; *Olcott v. Tioga R. R. Co.*, 27 N. Y. 546; *South Wales R. Co. v. Redmond*, 10 C. B. N. S. 675; *Bartlette v. Norwich and Worcester R. R. Co.*, 33 Conn. 560. Compare *Fitch v. New Haven, etc. R. R. Co.*, 30 Conn. 38. Or may purchase a steamboat. *Shawmut Bank v. Plattsburgh, etc. R. R. Co.*, 31 Vt. 491. But see *Hoagland v. Hannibal & St. Jo. R. R. Co.*, 39

Mo. 451; *Central R. R., etc. Co. v. Smith*, 76 Ala. 572.

² *Elkins v. Camden and Atlantic R. R. Co.*, 36 N. J. Eq. 241; *Sussex R. R. Co. v. Morris and Essex R. R. Co.*, 19 N. J. Eq. 13; *S. C.*, 20 N. J. Eq. 542; *Hare v. London and Northwestern R'y Co.*, 2 Johns. & Hem. 80. See *Hartford and N. H. R. R. Co. v. New York and N. H. R. R. Co.*, 3 Rob. (N. Y.) 411; *Columbus, P. and I. R. R. Co. v. Indianapolis and B. R. R. Co.*, 5 McLean, 450; *Androscoggin, etc. R. R. Co. v. Androscoggin R. R. Co.*, 52 Me. 417.

³ See *Johnson v. Shrewsbury, etc. R'y Co.*, 3 De G. M. & G. 914; *Gardner v. London, Chatham, etc. R'y Co.*, L. R. 2 Ch. 212; *State v. Hartford and N. H. R. R. Co.*, 29 Conn. 538.

⁴ It was so held in *Ohio and Mississippi R. R. Co. v. Indianapolis, etc. R. R. Co.* (Superior Ct. of Cin.), 5 Am. Law Reg. N. S. 733. See *Simpson v. Denison*, 10 Hare, 51;

pany might on its side have no power thus to extend its business.¹

§ 309. Different considerations arise regarding the validity of pooling arrangements or other contracts, the object of which is to prevent competition between parallel and, in the natural order of things, competing roads. In the absence of special authority, such contracts are *ultra vires*, and on grounds of public policy are illegal and void.² Thus, it is *ultra vires*, and illegal for one railroad company to purchase the stock of another with a view to obtain a controlling interest in the latter, and thus prevent competition between itself and the other company.³ So a contract whereby a railroad company agrees to give an express company exclusive privileges on its road is void; and the railroad company may be enjoined from carrying it out;⁴ and equally void is a contract giving ex-

compare *Midland R'y Co. v. Great Western R'y Co.*, L. R. 8 Ch. 841; *Attorney-General v. Great Eastern R'y Co.*, L. R. 11 Ch. D. 449.

¹ See cases in last note, also *Naugatuck R. R. Co. v. Waterbury Button Co.*, 24 Conn. 468, 482.

² *Hartford and N. H. R. R. Co. v. New York and N. H. R. R. Co.*, 3 Rob. (N. Y.) 411; *Stewart v. Erie and Western Trans'n Co.*, 17 Minn. 372; *Charlton v. Newcastle and Carlisle R'y Co.*, 5 Jur. N. S. 1096.

³ *Central R. R. Co. v. Collins*, 40 Ga. 582; *Hazlehurst v. Savannah, etc. R. R. Co.*, 43 Ga. 13; *Elkins v. Camden and Atlantic R. R. Co.*, 36 N. J. Eq. 5.

⁴ *Sandford v. Railroad Co.*, 24 Pa. St. 378; *New England Express Co. v. Maine Central R. R. Co.*, 57 Me. 188. See *Cumberland Valley R. R. Co.'s Appeal*, 62 Pa. St. 218.

A common carrier is as much bound to carry for other carriers, as for other persons. *Dinsmore v. Louisville C. and L. R'y Co.*, 2 Flippen, 672. See

Atchison T. and S. F. R. R. Co. v. Denver and N. O. R. R. Co., 110 U. S. 667. And cannot discriminate against an express company. *Southern Express Co. v. Memphis, etc. R. R. Cos.*, 2 McCrary, 570; see *Express Cos. v. Railway Cos.*, 3 McCrary, 147. But a contract whereby a railroad company agreed with a telegraph company to allow no other telegraph line to be constructed along the line of its railroad was held valid; there being several other lines of railroads between the important points on the road, and no necessity for constructing a telegraph line along it. *Western Union Tel. Co. v. Atlantic and Pac. Tel. Co.*, 7 Biss. 367; see also *Western Union Tel. Co. v. Chicago, etc. R. R. Co.*, 86 Ill. 246. Contra, *Western Union Tel. Co. v. Burlington, etc. R'y Co.*, 3 McCrary, 130. See *Atlantic and Pac. Tel. Co. v. Union Pac. R. R. Co.*, 1 McCrary, 541. Compare *Wright v. Ryder*, 36 Cal. 342; *Morris Run Coal Co. v. Barclay Coal Co.*, 68 Pa. St. 173.

clusive advantages to certain shippers over all others.¹ "Every common carrier must carry for all to the extent of his capacity, without undue or unreasonable discrimination either in charges or facilities."² The illegality of stipulations on the part of common carriers for exemption from liability for the negligence of their employes, is considered in a subsequent portion of the present chapter.³

§ 310. This examination of the legal relations arising from *ultra vires* transactions may be closed with an inquiry into the liability of a corporation to account for benefits which it has received under an *ultra vires*

Liability of corporations to account for

¹ *Messenger v. Pennsylvania R. R. Co.*, 37 N. J. L. 531; *S. C.*, 36 N. J. L. 407. The contract of a common carrier to allow drawbacks on freight to a party, and not to allow them to any other person, is against public policy and void. *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. L. 505. An injunction can be had to restrain a railroad company from agreeing not to transport goods at rates fixed by law. *Rogers' Locomotive Works v. Erie R'y Co.*, 20 N. J. Eq. 379. But, though it seems a common carrier can in no event charge more than a reasonable price, it is held that he may charge less to one person than to another; *Fitchburg R. R. Co. v. Gage*, 12 Gray (Mass.), 393; *Johnson v. Pensacola, etc. R. R. Co.*, 16 Fla. 623, 667; *Ragan v. Aiken*, 9 Lea (Tenn.), 609; *Munhall v. Pennsylvania R. R. Co.*, 92 Pa. St. 150; *Ex parte Benson*, 18 S. C. 38; *Houston, etc. R'y Co. v. Rust*, 58 Tex. 98. See *Atchison T. and S. F. R. R. Co. v. Denver and N. O. R. R. Co.*, 110 U. S. 667. A railroad company is under a duty to transport merchandise on equal terms for all parties, where the carrying for some shippers at a lower price than for

others will create monopoly or destroy the business of those less favored. *Scofield v. Railway Co.*, 43 O. St. 571.

So a contract to grant privileges for the withdrawal of opposition, based on public grounds, to proposed legislation concerning a railroad, is void. *Pingry v. Washburn*, 1 Aiken (Vt.), 264. Otherwise if the opposition rests on private grounds. *Low v. Conn. and P. R. R. Co.*, 46 N. H. 284.

² *Atchison T. and S. F. R. R. Co. v. Denver and N. O. R. R. Co.*, 110 U. S. 667, 674. Contracts between railroad and telegraph companies, vesting in the latter the exclusive right to use the railroad's right of way for telegraph poles, etc., are void, as against public policy, being in restraint of trade and tending to create monopolies. Railroad companies cannot convey to another company for its exclusive interests, and in antagonism to the public interest, property acquired by the railroad company through its right of eminent domain. *Western Union Tel. Co. v. American Union Tel. Co.*, 65 Ga. 160. See § 350 and notes.

³ §§ 352-354.

benefits
received
under an
ultra vires
contract.

contract, when it is seeking to repudiate the obligations thereof.

Here distinctions must again be taken between contracts which are merely *ultra vires*, and those which are also illegal. In regard to contracts merely *ultra vires* the general principle is stated by Mr. Brice as follows:¹ "But though a corporation cannot be sued, any more than any other citizen, directly upon a contract or analogous transaction which does not bind it, yet if it sets up this defence it must restore to the other party what it has obtained from him. It may repudiate the transaction if it chooses, but if so it must repudiate altogether—it cannot reprobate and approbate—it cannot reject and yet keep what in another form it has rejected."² Clear as this statement seems, it requires qualification in this respect: that the corporation may repudiate the contract without rendering up the benefits which through the contract have accrued to the corporate property, when such benefits have become amalgamated with the corporate property and cannot be rendered up without infringing the rights of persons who have never assented to the contract nor in any way acquiesced in it.³ In ascertaining the liability of the corporation, either directly on the contract, or indirectly for the benefits which through the contract have accrued to the corporate property, it must continually be borne in mind that the rights of different persons regarding the corporate property are distinguishable. Some persons may be in a position to say to the other contracting party, "take back what you can reach without disturbing my rights." The above-mentioned qualification, however, is applicable only where the benefits from the *ultra vires* contract have become undistinguishably interwoven with the corporate property, so as to make impossible a restitution *in integrum*.

§ 311. The simplest conceivable case for the application of the general rule, is where a corporation has received specific property real or personal, the distinguishing characteristics of which remain unimpaired after it has come into the possession of the corporation. In

Specific
chattels
must be
returned.
Money.

¹ *Ultra Vires*, 2d Eng. ed., p. 769.

³ See *Hill's Case*, L. R. 9 Eq. 605.

² See *Mannville v. Belden M'g*

Co., 5 McCrary, 391.

such case the property must be returned upon the repudiation of the contract in pursuance to which the corporation received it.¹ If money has been loaned to a corporation in furtherance of some scheme known to the lender to be *ultra vires*, it does not necessarily follow that the corporation will have to return the money, which may never have been applied to corporate purposes. Thus, where the directors of a building society, the rules of which gave directors no power to borrow, borrowed money for the purpose of advancing it to the members on the security of their shares, the lender's claim was disallowed on the winding up of the society.² In this case there was no proof that the money was ever applied to the proper purposes of the society or to the payment of any debt for which the society was liable.

On the other hand, when through an *ultra vires* transaction, money has come into the possession of a corporation and has been applied to proper corporate purposes by persons acting within the scope of their authority, the corporation in repudiating the transaction will have to refund the money so applied. Thus, in *Burges and Stock's Case*³ the holders of marine insurance policies, which the company was not authorized to issue, were allowed on the winding up of the company to recover the premiums paid by them on such policies; but were not allowed to recover the value of the policies, *Page-Wood, V. C.*, saying: "They have had no consideration for the premiums they paid. The directors, it is true, had no power to issue marine policies; but they had power to receive money and apply it to the benefit of the company. It is proved that they did so receive and apply these premiums, and the amount might have been recovered even at law as money had and received."⁴

¹ Compare § 277.

² *In re Nat. Permanent Benefit B'd'g Asso., Ex parte Williamson*, L. R. 5 Ch. 309.

³ 2 J. & H., 441.

⁴ See also *White v. Franklin Bank*, 22 Pick. 181; *Hawken v. Bourne*, 8 M. & W. 703; *Port of London Assur.*

Co.'s Case, 5 De G. M. & G. 465; *S. C.*, sub. nom. *Ernest v. Nicholls*, 6 H. L. C. 401; *Hall v. Mayor, etc. of Swansea*, 5 Q. B. 526; *In re Cork, etc. R'y Co.*, L. R. 4 Ch. 748, 760; *Humphrey v. Patrons' Mercantile Ass'n*, 50 Iowa, 607.

§ 312. The liability of a corporation to account for benefits received by it under an *ultra vires* transaction, does not rest on the circumstance that the other party has rendered services or parted with property,¹ nor on that circumstance combined with the further circumstance that the property of the corporation has received a benefit. The still further circumstance must exist that the benefit itself was appropriated to the uses of the corporation through some corporate agency acting within the scope of its express or implied authority.² No more than an individual can a corporation be compelled to account for money, property, or benefits thrust upon it without its consent. In such case the only remedy of the owner is to recover the identical property or its proceeds, if one or the other can be traced. Moreover, from the mere retention and use of a benefit, where there is no freedom of choice to reject or accept, no promise to pay or account for the same can be implied.³

§ 313. The rules already stated are not always nor altogether applicable to restitutions on the repudiation of contracts which, besides being *ultra vires*, are also unlawful.⁴

A party to a contract, the making of which, though prohibited by law, is not *malum in se*, may, while it remains executory, rescind it and recover money advanced by him thereon to the other party who has performed no part thereof. Permitting the plaintiff to recover back, is not carrying out the illegal transaction, but the effect is to put everybody in the situation they were in before the illegal contract was determined on.⁴ Thus, where a deposit was made in a bank, and

¹ Except where a specific piece of property may be handed back.

² *Hawtayne v. Bourne*, 7 M. & W. 595; *Ex parte Cropper*, 1 De G. M. & G. 147.

³ *In re Worcester Corn Exch. Co.*, 3 De G. M. & G. 180; *Zottman v. San Francisco*, 20 Cal. 96; *Murphy v. City of Louisville*, 9 Bush (Ky.), 189; *In re Kent Benefit B'd'g Soc.*, 1 Dr. & Sm. 417.

⁴ *Spring Co. v. Knowlton*, 103 U. S. 49; *Oneida B'k v. Ontario B'k*, 21 N. Y. 490; *White v. Franklin B'k*, 22 Pick. 181; *Dill v. Wareham*, 7 Metc. (Mass.) 488; *Whitney v. Peay*, 24 Ark. 22; *Foulke v. San Diego, etc. R. R. Co.*, 51 Cal. 365; *Philadelphia Loan Co. v. Towner*, 13 Conn. 249. Compare *Brooks v. Martin*, 2 Wall. 70.

the depositor received a book containing the cashier's certificate that the money was to remain on deposit a certain length of time, it was held that such stipulation was void as amounting to a contract on the part of the bank for the payment of money at a future day certain; a contract prohibited by statute. But the court held that, though no action could be maintained by the depositor on the stipulation, still he could recover back the money before the expiration of the time for which it was to remain on deposit, and that, too, without any previous demand on the bank.¹ It will be noticed that in this case, though the express contract was beyond the cashier's authority, yet receiving the money on deposit was not, and so the money was actually applied to the purposes of the bank by its agent acting within his powers.

Sometimes a harsher doctrine is applied. Undoubtedly the right of a party to an illegal contract to have it rescinded rests on public policy rather than on any rights of the party himself. And so a corporation, without regard to the fact that it is *particeps criminis*, may invoke the aid of a court to relieve it from an illegal contract; for the relief is regarded as given to the public through the party in whose name it is sought. Thus, in a New York case, it was held that a lease taken by a railroad company for the purpose of extending its road beyond its chartered terminus was *ultra vires* and void, and would be set aside on the application of a party to it. But it was also held that the court would not relieve the parties any further than the public interest required, and accordingly no recovery was permitted for the use of the leased property previous to the time when the lease was declared invalid.²

§ 314. Persons who at the expense of a corporation have received benefit from an *ultra vires* transaction, even a transaction that is illegal as against public policy, may have to refund to the corporation to the extent of the benefit they have received.³ Where, however, both the

Liability of
other party
to account.

¹ White v. Franklin B'k, 22 Pick. 181.

² Union Bridge Co. v. Troy, etc. R. R. Co., 7 Lans. (N. Y.) 240.

³ Brice, *Ultra Vires*, 2d Eng. ed.,

p. 814. See Bryson v. Warwick, etc. Canal Co., 1 Sm. & G. 447; S. C., 4 De G. M. & G. 711; Ernest v. Croysdill, 2 De G. F. & J. 175; Zulueta's Claim, L. R. 5 Ch. 444; Hardy v.

corporation and the other contracting party have received benefits under a partially executed *ultra vires* contract, the corporation, it is held, cannot retake its property, which under the contract has passed to the other contracting party, without offering to return the property of the other party, which, through the same contract, has come into the possession of the corporation; and, at all events, a corporation will be enjoined from taking possession of its former property under such circumstances till a judicial settlement and accounting can be had.¹

The litigation in the cases cited in the note arose from transactions which were not only *ultra vires*, but, on grounds of public policy, illegal. In one of them, *American Union Tel. Co. v. Union Pacific Railway Co.*, Judge McCrary said:² "Many cases hold that a corporation which has made a contract *ultra vires*, which has not been fully performed, is not estopped from pleading its own want of power; but that doctrine does not apply to a case where a party comes into a court of equity, and, while retaining all that he has received upon such a contract, asks to be permitted to retake what he has parted with under it. I take it there is nothing in the law, as there is certainly nothing in the principles of equity, to estop the court from saying that the obligation to return the property transferred under these contracts is mutual, and shall not be enforced against one of the parties without being, at the same time, enforced against the other. As the parties and the subject-matter are now before the court, it is the duty of the court, so far as is possible, to place them in *statu quo*."³

§ 315. In a treatise on the law of stock corporations very little of the law relating to municipal corporations will be included; the latter being very different legal institutions and subserving very different purposes from the former. "A municipal corporation," says Justice

Metropolitan Land Co., L. R. 7 Ch. 427.

¹ *American Union Tel. Co. v. Union Pac. R'y Co.*, 1 McCrary, 188; *Atlantic and Pac. Tel. Co. v. Union Pac. R'y Co.*, ib. 541; *Central Branch U. P. R. R. Co. v. Western Union Tel.*

Co., ib. 551; *Western Union Tel. Co. v. Burlington, etc. R'y Co.*, 3 McCrary, 130.

² 1 McCrary, 188, 201.

³ See also *Madison Ave. Bap. Church v. Oliver Street Bap. Church*, 73 N. Y. 82.

Hunt, "in the exercise of all its duties, including those most strictly local or internal, is but a department of the state. The legislature may give it all the powers such a being is capable of receiving, making it a miniature state within its locality. Again, it may strip it of every power, leaving it a corporation in name only; and it may create and recreate these changes as often as it chooses, or it may exercise directly within the locality any or all of the powers usually committed to a municipality."¹ The case from which this citation is taken held a municipal corporation responsible for negligence in the management of its streets; and the decision is undoubted law. Nevertheless, a municipal corporation may not be liable for misfeasance or non-feasance in all respects like a private corporation,² and to reason by analogy from the one kind of corporation to the other may cause error.

§ 316. Municipal corporations have little if any inherent jurisdiction to make laws or adopt governmental regulations. They can exercise no powers in this respect which are not given them expressly or impliedly by their charters, or by other statutes or the constitution of the state. There is no contract implied between a municipal corporation and the state; and the state may alter their constitutions in any way, may divide one municipal corporation into two or more, and may apportion between the new corporations the property and burdens of the former corporation. When a municipal corporation is legislated out of existence and its territory is annexed to other corporations, the latter, unless the legislature otherwise provides, become entitled to its property and immunities, and severally liable for a proportionate share of all its subsisting legal debts, as well as vested with its powers of taxation to raise revenue with which to pay them. The remedy of creditors of an extinguished municipal corporation is in equity against the corporation succeeding to its property and powers.³ A change in its

¹ *Barnes v. District of Columbia*, 91 U. S. 540, 544.

² See *Fowle v. Common Council of Alexandria*, 3 Pet. 398, 409; and § 177. Compare generally *Vidal v. Girard's Executors*, 2 How. 127.

³ *Mount Pleasant v. Beckwith*, 100 U. S. 514. See *Newton v. Commissioners*, ib. 548; *East Hartford v. Hartford Bridge Co.*, 10 How. 511.

charter, by amendment or the substitution of a new one, will not be deemed to affect the identity of the corporation or relieve it from its previous liabilities, when substantially the same corporations and territory are embraced under the new charter.¹

§ 317. Still, however much in their organization and purposes municipal corporations may differ from stock corporations, the liability of the former on their bonds issued in aid of railroad and other business enterprises of public importance is in many respects similar to the liability of the latter on their contracts. In especial, the rules governing the effect of recitals in municipal bonds are almost identical with the rules which determine the liability of stock corporations for the acts of their agents, when the authority of the agent to act is conditioned on facts peculiarly within his knowledge.² Moreover, the rule that every person dealing with a corporation, private or municipal, is affected with notice of the corporate powers, is strikingly exemplified in the law of municipal bonds. For these reasons municipal bonds will be the subject of discussion in the next few pages.

§ 318. A large proportion of the suits on municipal bonds are brought in the Federal courts; consequently, that admirable course of decisions by which the Supreme Court of the United States has upheld the validity of municipal bonds against various defences, is of almost universal authority and application.³ The Federal courts will follow an unbroken line of decisions of the highest court of a state construing its constitution and statutes.⁴ But the rights of *bona fide* holders of municipal bonds are to be determined by the law as judicially construed when the bonds in litigation were put on the market; and the United States Supreme Court will not follow the later decisions of a state tribunal in conflict with decisions under which the rights of such holders arose.⁵ Ac-

¹ Broughton v. Pensacola, 93 U. S. 266. 92 U. S. 289; Claiborne County v. Brooks, 111 U. S. 400.

² See §§ 203-207.

⁵ Douglass v. County of Pike, 101

³ Regarding the jurisdiction of the Federal Circuit Courts see Bernard's Township v. Stebbins, 109 U. S. 341. U. S. 677; Green County v. Conness, 109 U. S. 104; Anderson v. Santa Anna, 116 U. S. 356.

* Township of Elmwood v. Marcy,

cordingly, when by a series of decisions the highest court of a state has held that the state legislature could competently authorize municipal corporations to issue bonds in aid of railroads extending beyond the limits of the town or county issuing the bonds, and those decisions have been approved by the Federal Supreme Court, the fact that subsequently the highest court of the same state has held its former decisions erroneous, will, in a Federal court, have no effect on the rights of *bona fide* holders arising from transactions which occurred before the change in state judicial opinion had been promulgated. Under such circumstances Federal courts will not follow the oscillations of state courts.¹ Moreover, when the question of the validity of municipal bonds held by an innocent holder comes before the Supreme Court of the United States, that court in its discretion may disregard the decisions of a state court, although they involve the construction of a statute of the state, if those decisions are not deemed satisfactory. Such a question belongs to the domain of general jurisprudence, and the Federal courts will not be controlled by state decisions.²

§ 319. A municipal corporation has, of course, no implied or inherent power to issue bonds in aid of railroad enterprises;³

¹ *Gelpcke v. City of Dubuque*, 1 Wall. 175; *Havemeyer v. Iowa County*, 3 Wall. 294. See *Columbia County v. King*, 13 Fla. 451.

² *Township of Pine Grove v. Talcott*, 19 Wall. 666; *Town of Venice v. Murdock*, 92 U. S. 494; see *Swift v. Tyson*, 16 Pet. 1; *Oates v. National Bank*, 100 U. S. 239; *Railroad Co. v. National Bank*, 102 U. S. 14; *Pana v. Bowler*, 107 U. S. 529; *Carroll County v. Smith*, 111 U. S. 556. See also § 468.

³ *Kenicott v. Supervisors*, 16 Wall. 452; *Thomson v. Lee County*, 3 Wall. 327; *Hancock v. Chicot County*, 32 Ark. 575; see *City of Lynchburg v. Slaughter*, 75 Va. 57. Compare *Bell v. Railroad Co.*, 4 Wall. 598.

An injunction lies to restrain an issue of bonds where there has been a material departure from the statute. *Union Pac. R. R. Co. v. Lincoln Co.*, 3 Dillon, 300; *City of Madison v. Smith*, 83 Ind. 502. See *Noesen v. Town of Port Washington*, 37 Wis. 168; and compare *Rogers v. Burlington*, 3 Wall. 654, 667. A taxpayer has a standing in court to maintain such an injunction. *Winston v. Tennessee & P. R. R. Co.*, 1 Bax. (Tenn.) 82. But bonds of a municipal corporation which are void in the hands of an innocent holder are no charge against the public, and a taxpayer has no right to enjoin their circulation. *McCoy v. Briant*, 53 Cal. 247.

nor any implied power to utter commercial paper of any kind.¹

Municipality has no inherent power to issue railway aid bonds.

State legislatures, however, unless prohibited by some constitutional provision, may authorize a town or county to aid in the construction of a railroad by subscribing for shares in the stock of a railroad corporation and issuing bonds in payment therefor, or by issuing its bonds as a simple gift to the corporation.² And this it is competent for a legislature to do, with or without the popular vote of the municipality,³ although the projected railroad lie outside of the county or even the state; provided the building of the road will give the county a desirable connection with some other region.⁴ The constitutionality of such legislation is based on the view that the construction of a railroad is of such general utility that taxation in aid thereof is constitutional, being for a public purpose.⁵

¹ *Claiborne County v. Brooks*, 111 U. S. 400.

² *Thomson v. Lee County*, 3 Wall. 327; *Railroad Co. v. County of Otoe*, 16 Wall. 667; *Town of Queensbury v. Culver*, 19 Wall. 83; *Clarke v. City of Rochester*, 28 N. Y. 605; *Davidson v. County Commissioners*, 18 Minn. 482; *Chicago, Danville, etc. R. R. Co. v. Smith*, 62 Ill. 268; *Leavenworth County v. Miller*, 7 Kan. 479 (in which last case a full review of authorities is given). *Stockton, etc. R. R. Co. v. City of Stockton*, 41 Cal. 147; *Petty v. Myers*, 49 Ind. 1; *Leavenworth, etc. R. R. Co. v. Douglass County*, 18 Kan. 169; *New Orleans, etc. R. R. Co. v. McDonald*, 53 Miss. 240. See *Township of Pine Grove v. Talcott*, 19 Wall. 666, 677; *Dillon on Municipal Corps.*, 3d ed., § 153, note. Compare *City of Ottawa v. Carey*, 103 U. S. 110. Contra, *People v. Salem*, 20 Mich. 452; *Whiting v. Sheboygan, etc. R. R. Co.*, 25 Wis. 167; *Hanson v. Vernon*, 27 Iowa, 28. The last case was virtually overruled in

Stewart v. Polk County, 30 Iowa, 1.

In the cases cited in the following notes the constitutionality of such legislation is affirmed or assumed. The power to issue municipal bonds imports the power to sell and make them payable beyond the limits of the state. *Lynde v. The County*, 16 Wall. 6.

³ *Railroad Co. v. County of Otoe*, 16 Wall. 667; *Otoe County v. Baldwin*, 111 U. S. 1.

⁴ *Railroad Co. v. County of Otoe*, 16 Wall. 667. See *Kirkbride v. Lafayette County*, 108 U. S. 208.

⁵ See *Olcott v. Supervisors*, 16 Wall. 678; and cases in last note but one. Accordingly, legislation authorizing an issue of municipal bonds to aid a private business enterprise is unconstitutional, and the bonds are void. *Loan Ass'n v. Topeka*, 20 Wall. 655; *Parkersburg v. Brown*, 106 U. S. 487; *Osborne v. County of Adams*, 106 U. S. 181; *Cole v. La Lagrange*, 113 U. S. 1. Where, however, a statute declares all custom grist-mills to be "public mills," and regulates their

§ 320. In order that municipal bonds issued in aid of a railroad may have any validity in the hands of any one, special authority must have been given by the legislature to the municipality to issue them. This is unquestionable law.¹ And every holder of municipal bonds, whether he receive them directly from the town or county, or from the railroad corporation to which they may have been delivered, or take them from some prior holder in the ordinary course of business, is chargeable with notice of the statutory provisions under which they were issued.² More-

Special
authority
requisite.
Holders
charged
with notice.

management, the legislature may authorize a municipal corporation to issue bonds in aid of such a mill, although it is owned by a private individual. *Township of Burlington v. Beasley*, 94 U. S. 310; *Blair v. Cuming County*, 111 U. S. 363; but compare *C. B. U. P. R. Co. v. Smith*, 23 Kan. 745.

¹ *Wells v. Supervisors*, 102 U. S. 625; *Welsh v. Post*, 99 Ill. 471; *Hays v. Holly Springs*, 114 U. S. 120; *Jonesboro City v. Cairo, etc. R. R. Co.*, 110 U. S. 192; *Concord v. Robinson*, 121 U. S. 165. See *Allen v. Louisiana*, 103 U. S. 80; and cases in next note. Where there is a total want of authority to issue municipal bonds, there can be no *bona fide* holding of them. *Township of East Oakland v. Skinner*, 94 U. S. 255. See *Welch v. Post*, *supra*. And the authority must not have been revoked before the actual issue of the bonds. *Town of Concord v. Portsmouth Savings Bank*, 92 U. S. 625. The charter of a railroad company authorized the county commissioners of a county through which the railroad passed, to subscribe for stock and issue bonds, provided a majority of qualified voters of the county should vote in favor of such action. A favorable vote was had; but before the subscription was made the State adopted a new consti-

tution which prohibited such subscriptions unless paid in cash and forbade counties to loan their credit to any corporation or to borrow money in order to take stock. It was held that the provisions in the railroad charter authorizing the commissioners to subscribe, conferred a power on a public corporation which could be modified by legislative authority; that the charter did not import a contract on the part of the State with the railroad corporation that counties should continue competent to issue bonds; and that the bonds issued after the new state constitution had gone into effect were void. *Aspinwall v. Commissioners of the County of Daviess*, 22 How. 364; confirmed in *Wadsworth v. Supervisors*, 102 U. S. 534. Compare *Supervisors v. Galbraith*, 99 U. S. 214.

² *Ogden v. County of Daviess*, 102 U. S. 634; *United States v. County of Macon*, 99 U. S. 582; *Anthony v. County of Jasper*, 101 U. S. 693; *Town of South Ottawa v. Perkins*, 94 U. S. 260; *McClure v. Township of Oxford*, 94 U. S. 429; *Ottawa v. Casey*, 108 U. S. 110; *Lewis v. City of Shreveport*, 108 U. S. 282; *Hoff v. Jasper County*, 110 U. S. 53; *Woodruff v. Town of Okolona*, 57 Miss. 806; *Tax Payers v. Tennessee Central*

over, that which is not a valid law can give no validity to municipal bonds which purport to be issued by virtue of it, even when those bonds have passed into the hands of *bona fide* holders for value.¹

To constitute a "subscription" by a county to stock in a railroad company it is not necessary that there be an actual subscribing in the books of the company. If a county passes a resolution declaring a subscription made, which the company accepts, notifying the county: and the county delivers its bonds in payment, accepts shares of stock, votes as a shareholder, and levies a tax to pay the interest on its bonds, it will be estopped, as against a *bona fide* holder of the bonds, from denying its subscription; assuming that it had power to subscribe. And the county will not be released by a subsequent alteration in the organization or purposes of the railroad company, unless the alteration is fundamental, and, in addition, is not provided for or contemplated either by the charter of the company or the general laws of the state.² As Chief Justice Waite said, giving the opinion of the Federal Supreme Court in *Bates County v. Winters*: "An actual manual subscription on the books of a railroad company is not indispensably necessary to bind a municipality as a subscriber to the capital stock. If the body or agency having authority to make such subscription passes an ordinance or a resolution to the effect that it does thereby, in the name and on the behalf of the municipality, subscribe a specified amount of stock, and presents a copy of that ordinance or resolution to the company for acceptance as a subscription, and the company does in fact accept, and notifies the municipality, or its proper agent,

R. R. Co., 11 Lea (Tenn.), 329; *Potter v. Greenwich*, 26 Hun (N. Y.), 326, S. C., 92 N. Y. 662. Although the law authorizing the subscription be silent on the subject, the municipality in voting may impose conditions on which the subscription is to depend. *People v. Glann*, 70 Ill. 232; see *People v. Holden*, 91 Ill. 446.

¹ *Post v. Supervisors*, 105 U. S. 667. Whether a seeming act of the legislature is a law, is a judicial question for the court, not for the jury. *Ib.* In *Norton v. Shelby County*, 118 U. S. 425, 442, Field, J., said, giving the opinion of the court: "An unconstitutional act is not a law; it confers no rights; it imposes no duties; it affords no protection; it creates no office; it is, in legal contemplation, as inoperative as though it had never been passed."

² *Nugent v. Supervisors*, 19 Wall. 241.

to that effect, the contract of subscription is complete, and binds the parties according to its terms."¹

§ 321. State bonds, as well as municipal bonds, issued in excess of a constitutional limitation are void.² Accordingly, when a state constitution declares that no city or other municipal corporation shall become indebted in any way for any purpose to an amount, including existing indebtedness, in the aggregate exceeding five per cent. on the value of the taxable property therein, bonds issued in excess cannot be recovered on.³ Further, a constitutional provision prohibiting the creation of indebtedness by a direct loan of municipal credit does not permit an indirect use of such credit for the same purpose.⁴

Constitutional limitations.

¹ 112 U. S. 325, 327.

² Williams v. Louisiana, 103 U. S. 637. Where a county court issues bonds in excess of the amount authorized by the statute, the over-issue is void. The bonds delivered before the limit was reached are the valid ones. Daviess County v. Dickinson, 117 U. S. 657.

³ Buchanan v. Litchfield, 102 U. S. 278. But the court seemed to think that if the bonds had recited properly that the indebtedness was not in excess of the amount allowed, the recital would have been conclusive in favor of *bona fide* holders for value: and they quæried whether the city is bound to refund to the proper parties the money which her authorized agents had received for the bonds. See School District v. Stone, 106 U. S. 183; § 332. It has subsequently been held that a *bona fide* holder for value of municipal bonds is not required to look beyond the law authorizing the issue and the recitals in the bonds, to inquire as to the amount of the county indebtedness. Where commissioners estimate the county indebtedness for the purpose of the issue, that estimate,

also, whether true or false, is conclusive in favor of *bona fide* holders. Sherman County v. Simons, 109 U. S. 735. So municipal bonds are not invalid in the hands of a *bona fide* holder, by reason of their having been voted and issued in excess of the statutory limit, if the recitals import a valid issue. Dallas County v. McKenzie, 110 U. S. 686; Marcy v. Township of Oswego, 92 U. S. 637; Humboldt Township v. Long, 92 U. S. 642.

In Louisiana v. Wood, 102 U. S. 294, it was held when a city borrows money on its bonds concededly invalid *for want of registration*, the money paid for them may be recovered back with lawful interest. Quære, whether this last decision would apply if the bonds for which the money was paid had been issued in contravention of a constitutional restriction?

⁴ Jarrolt v. Moberly, 103 U. S. 580. An act forbidding, under certain penalties, the officers of a municipal corporation from subscribing for railroad stock, without the previous assent of two-thirds of the qualified voters, is in itself no authority to loan money when such assent is given. Ib.

§ 322. A statute authorizing a municipal corporation to lend its credit to a specified railroad company and "to any other railroad company duly incorporated and organized for the purpose of constructing railroads" leading in a direction specified, empowers the corporation to lend its credit to a railroad company duly incorporated subsequently to the passage of the act, as well as to one in existence when the act was passed.¹ And municipal bonds will not be rendered invalid in the hands of a *bona fide* holder, by the fact that the railroad company, in payment for whose stock the bonds were issued, was not in existence when the vote was passed authorizing the subscription.² But where a statute authorized a town to appropriate money to aid in constructing a certain railroad as soon as its track *should have been* located and constructed through the town, it was held that the town could make no appropriation until the road was so located and constructed.³ Likewise where the popular vote, taken in accordance with a statute, authorized a subscription to one railroad company, and the bonds were issued to another railroad company, this appearing on the bonds themselves, the lack of authority is evident from the face of the bonds, and there can be no *bona fide* holder of them.⁴

§ 323. In the case of *March v. Fulton County*,⁵ a railroad company subsequent to its incorporation was divided into three divisions, and each division incorporated as a distinct corporation. A vote of the people of the county had authorized the bonds, whose validity was before the court, to be issued to the original corporation; and the court held that they could not under this vote be validly

¹ *James v. Milwaukee*, 16 Wall. 159. A city authorized "to obtain money on loan, on the faith and credit of said city, for purposes of contributing to works of internal improvement," may guarantee bonds of a railroad company whose road runs through the city. *City of Savannah v. Kelly*, 108 U. S. 184. In regard to the meaning of the phrase "corporate purposes," see *City of Ottawa v. Carey*, 108 U. S. 110.

² *County of Daviess v. Huidekoper*, 98 U. S. 98.

³ *Town of Concord v. Portsmouth Savings Bk.*, 92 U. S. 625. See *County of Moultrie v. Savings Bk.*, 92 U. S. 631; *Railroad Co. v. Falconer*, 103 U. S. 821. Compare *County of Randolph v. Post*, 93 U. S. 502.

⁴ *County of Bates v. Winters*, 97 U. S. 83.

⁵ 10 Wall. 676.

issued to one of three new corporations. It is to be noticed, however, that the statute which in this case permitted counties to issue their bonds in aid of railroad enterprises, required the notices of election to specify the corporation to which it was proposed to issue them.¹ The Federal Supreme Court has also held that although a subscription to the stock of a railroad company be duly authorized by the requisite vote, yet if before the subscription be actually made the company becomes consolidated with another, thereby forming a third, a subscription to the stock of the new corporation and the issue of bonds therefor are unauthorized.²

§ 324. It may be questioned whether the case last referred to, *Harshman v. Bates County*, would be followed now by the Supreme Court; for that court has since held in more than one instance, that when a municipal corporation is authorized to issue its bonds to a railroad company, the consolidation of that company with another does not destroy the power of the county to issue its bonds nor the right of the railroad company to receive them.³ And bonds voted in aid of one company, which under the law then in force, was subsequently consolidated with another, may be delivered to the consolidated company.⁴

§ 325. Municipal bonds, invalid in their inception, may be validated by legislative sanction or even recognition.⁵ For, in

¹ Municipal bonds voted and delivered to a corporation under a changed name are not by such change invalidated. *Town of Reading v. Wedder*, 66 Ill. 80.

² *Harshman v. Bates County*, 92 U. S. 569. See *Wagner v. Meety*, 69 Mo. 150.

³ *Menasha v. Hazard*, 102 U. S. 81; *County of Scotland v. Thomas*, 94 U. S. 682; *Town of East Lincoln v. Davenport*, 94 U. S. 801; *County of Henry v. Nicolay*, 95 U. S. 619. See *County of Cass v. Gillett*, 100 U. S. 585; *County of Schuyler v. Thomas*, 98 U. S. 169; *Wilson v. Salamanca*,

99 U. S. 499; *County of Tipton v. Locomotive Works*, 103 U. S. 523; *Harter v. Kernochan*, 103 U. S. 562; *Scott v. Hansheer*, 94 Ind. 1; *Edwards v. People*, 88 Ill. 340, and § 536.

⁴ *New Buffalo v. Iron Company*, 105 U. S. 73; *Chickaming v. Carpenter*, 106 U. S. 663; *Nugent v. Supervisors*, 19 Wall. 241; *Bates County v. Winters*, 112 U. S. 325; *Niantic Savings Bank v. Town of Douglas*, 5 Ill. App. 579.

⁵ *Grenada County Supervisors v. Brogden*, 112 U. S. 261; *Campbell v. City of Kenosha*, 5 Wall. 194.

the absence of constitutional restrictions, a legislature may competently validate, by retrospective statutes, an irregular or defective execution of a power by a municipal or other public corporation.¹ Moreover, the levy of a tax and the payment of interest by the proper municipal authorities have been held to validate, in the hands of *bona fide* holders for value, county bonds irregular in their origin.²

§ 326. Municipal bonds, made payable to bearer (or, as is unusual, to order) are negotiable;³ they are transferable by

¹ *Otoe County v. Baldwin*, 111 U. S. 1; *Gelpcke v. Dubuque*, 1 Wall. 175, 203; *Tift v. City of Buffalo*, 82 N. Y. 204; *Keithburg v. Frick*, 34 Ill. 405; *Copes v. Charleston*, 10 Rich. L. (S. C.) 491; *McMillen v. Boyles*, 6 Iowa 304; *McMillen v. Judge of Lee County*, ib. 391; *Bass v. City of Columbus*, 30 Ga. 845; *Steines v. Franklin County*, 48 Mo. 167; *Knapp v. Grant*, 27 Wis. 147; *Town of Duaneburg v. Jenkins*, 57 N. Y. 177. Compare *White Mountains R. R. Co. v. White Mountains R. R.*, 50 N. H. 50; *Gross v. United States Mortgage Co.*, 108 U. S. 477; *Alexander v. Commissioners of McDowell County*, 70 N. C. 208; *Single v. Supervisors*, 38 Wis. 363. But see *Cairo and St. L. R. R. Co. v. City of Sparta*, 77 Ill. 505. But a legislature cannot validate municipal bonds by a statute passed after a constitutional amendment has forbidden the legislature to authorize municipal bonds; *Katzenberger v. Aberdeen*, 121 U. S. 172.

A law requiring a municipal corporation to pay a demand which is without legal obligation, but which is equitable and just in itself, being founded on a valuable consideration received by the corporation, is not a retrospective law, any more than would

be an appropriation for the payment of a pre-existing claim. Read *v. Plattsmouth*, 107 U. S. 568. But compare *Coosa River Steamboat Co. v. Barclay*, 30 Ala. 120.

² *Gelpcke v. City of Dubuque*, 1 Wall. 176; *Havemeyer v. Iowa County*, 3 Wall. 294; *Supervisors v. Schenck*, 5 Wall. 772; *Lee County v. Rogers*, 7 Wall. 181; *Commissioners of Johnson County v. January*, 94 U. S. 202; *County of Jasper v. Ballou*, 103 U. S. 745; see also *Hannibal and St. Jo. R. R. Co. v. Marion County*, 36 Mo. 294; *Barrett v. County Court*, 44 Mo. 197.

³ *Commissioners of Marion County v. Clark*, 94 U. S. 278; *Oubre v. Donaldsonville*, 33 La. Ann. 386; *City of Mount Vernon v. Hovey*, 52 Ind. 563; *Blackman v. Lehman*, 63 Ala. 547. And this although the corporate seal is attached. *Mercer County v. Hackett*, 1 Wall. 83. But county warrants are not negotiable. *Wall v. County of Monroe*, 103 U. S. 74; *County of Ouachita v. Wolcott*, 103 U. S. 559. And a purchaser before maturity, unless he is personally chargeable with fraud in procuring them, can recover the full amount of their par value, although he has paid less, and the bonds were originally

delivery without indorsement,¹ and the holder may sue in his own name.² Likewise, the interest coupons, attached to municipal bonds payable to bearer, are themselves negotiable and transferable by delivery when separated from the bonds.³ An overdue and unpaid interest coupon, attached to a bond which has several years to run, does not render the bond and the subsequently maturing coupons dishonored paper, so as to subject them in the hands of a purchaser for value to defences good against the original holder.⁴

Bonds and coupons negotiable.

affected by some infirmity. *Cromwell v. County of Sac*, 96 U. S. 51. Where an original issue of its bonds may have been illegal, and a city redeems them with legal bonds, the illegality of the original issue does not prejudice the holder of legal bonds, which he has received on surrendering the illegal bonds. *Little Rock v. National Bank*, 98 U. S. 308. The legality of the original claims against a town cannot be inquired into in a suit on bonds issued to compromise them. *Dugas v. Town of Donaldsonville*, 33 La. Ann. 668; *S. C. and St. P. R. Co. v. Osceola County*, 52 Iowa, 26.

The court will not readily construe a municipal bond to contain a condition making it payable on a contingency, and so non-negotiable. *Humboldt Township v. Long*, 92 U. S. 642. The holder of a municipal bond is presumed to have acquired it in good faith. He need not have given value for it if an intermediate holder did, and he succeeds to all the latter's rights. *Montclair v. Ramsdell*, 107 U. S. 147.

¹ If originally made payable to order, *e. g.*, of the railroad company in aid of which they are issued, municipal bonds would, of course, have to be indorsed in blank or to bearer, be-

fore they would be transferable by delivery without indorsement.

² *Ottawa v. National Bank*, 105 U. S. 342.

³ *City of Lexington v. Butler*, 14 Wall. 282; *Grand Chute v. Winegar*, 15 Wall. 355; *Clark v. Iowa City*, 20 Wall. 583; *Walnut v. Wade*, 103 U. S. 623; *Ohio v. Frank*, *ib.* 697.

⁴ *Cromwell v. County of Sac*, 96 U. S. 51. And overdue interest coupons detached from a bond not yet matured are negotiable. *Thompson v. Perrine*, 106 U. S. 589. Quære, as to the scope of the decision in this last case; for the statute of limitations runs against coupons from the time they are due, whether they are detached from their bonds or not. *Amy v. Dubuque*, 98 U. S. 470; *Koshkonong v. Burton*, 104 U. S. 668.

In a suit on municipal bonds, the holder of the bonds and the unpaid coupons is entitled to interest on unpaid interest from the time it fell due. *Rich v. Town of Seneca Falls*, 19 Blatchf. 558; although there has been no demand for payment, *McLendon v. Commissioners*, 71 N. C. 38; but there must have been default on the part of county, either in the payment of the principal debt or the coupons. See *Aurora City v. West*, 7 Wall. 82;

§ 327. The rule that all persons are affected with notice of a suit pending in regard to the title to property, and that every one buys the same at his peril from any of the litigating parties, does not apply to municipal bonds and other commercial securities, purchased before maturity.¹ But a person who buys overdue municipal bonds which have been adjudged void, is bound by the judgment.²

Holder not affected with notice of *his pendens*.

§ 328. An important consequence of the principle that municipal bonds payable to bearer are negotiable, is that “the omission of formalities and ceremonies or the existence of fraud on the part of the agents of the municipality issuing their bonds cannot be urged against a *bona fide* holder seeking to enforce them.”³ For “when a cor-

Presumptions.

Gelpcke v. Dubuque, 1 Wall. 175. The right to interest on interest, whether arising on an express or on an implied agreement, if allowed by statutes in force when the bonds were issued, cannot be impaired by subsequent legislation declaring the true intent and meaning of those statutes. Koshkonong v. Burton, 104 U. S. 668.

¹ County of Warren v. Marcy, 97 U. S. 96; County of Cass v. Gillett, 100 U. S. 585; Carroll County v. Smith, 111 U. S. 556; Enfield v. Jordan, 119 U. S. 680. See also County of Macon v. Shores, 97 U. S. 272; Leitch v. Wells, 48 N. Y. 585; Stone v. Elliott, 11 Ohio St. 252; Kieffer v. Ehler, 18 Pa. St. 388; Winston v. Westfeldt, 22 Ala. 760.

² Louis v. Brown Township, 109 U. S. 162. And persons buying negotiable securities with actual notice of the pendency of a suit affecting the title or validity act at their peril, and must abide the result and will be concluded by the judgment. Scotland County v. Hill, 112 U. S. 183.

³ Kenicott v. Supervisors, 16 Wall. 452, 465; Grand Chute v. Winegar, 15 Wall. 355; Meyer v. City of Muscatine, 1 Wall. 384; State v. Saline County Court, 48 Mo. 390. But compare Jacksonville, etc. R. R. Co. v. Town of Virden, 104 Ill. 339. The absence of a seal does not affect the right of a *bona fide* holder to recover. Draper v. Springfield, 104 U. S. 501. Compare Bank v. Statesville, 84 N. C. 169. When commissioners authorized to issue town bonds are directed by the statute to affix their seals, and omit to do so, a bill in equity lies by the *bona fide* holders to restrain the township from pleading the want of seals. Bernard's Township v. Stebbins, 109 U. S. 341. All qualified voters, who absent themselves from an election held on public notice duly given, are presumed to assent to the expressed will of the majority of those voting; unless the law providing for the election otherwise declares. County of Cass v. Johnston, 95 U. S. 360; Carroll County v. Smith, 111 U. S. 556.

poration has power under any circumstances to issue negotiable securities, the *bona fide* holder has a right to presume that they were issued under the circumstances that give the requisite authority, and they are no more liable to be impeached for any infirmity in the hands of such a holder than any other commercial paper.”¹

§ 329. The last statement in the text is the reiterated language of the Supreme Court of the United States.

Yet it seems broader than was required for the decision of any case in which it was used in regard to municipal bonds.² If a corporation has a general power to issue negotiable securities, any person may purchase them on the assumption that they were competently issued in the course of authorized transactions.³ But when a corporation—at least a municipal corporation—has but a special and conditioned power to issue negotiable securities for a specified purpose, it seems to the writer the Supreme Court has never actually decided that from the simple bald fact that the securities were issued, and signed by the proper officers, the commercial public is entitled to assume them to have been issued for the special purpose authorized by law, and that all conditions precedent to the authority of the officers to issue them had been fulfilled.⁴ The Supreme Court *decisions* warrant the following proposition, however: When a municipal corporation, having authority, upon the fulfilment of certain conditions, to issue negotiable bonds for a specific purpose, issues its bonds signed by the proper officers, and from the statements or recitals contained in the bonds it may fairly be inferred that the bonds were issued

Effect of
recitals.

¹ *Gelpcke v. Dubuque*, 1 Wall. 175, 203; *City of Lexington v. Butler*, 14 Wall. 282; see § 205. But if the plaintiff is the railroad company, or is not an innocent holder, the inquiry whether formalities and conditions precedent have been complied with remains entirely open. *Chambers County v. Clews*, 21 Wall. 317.

² For instance, in *City of Lexington v. Butler*, 14 Wall. 282, where this general language is used, there were

recitals in the bonds importing that the bonds were issued for the purpose authorized by the statute, and in compliance therewith. A complaint on a bond issued by a town having authority to issue bonds for certain purposes, should state the purpose for which the bond was issued. *Hopper v. Covington*, 118 U. S. 148.

³ See § 205.

⁴ See *Merchants' Bank v. Bergen County*, 115 U. S. 384.

for the authorized purpose, and that the conditions precedent had been fulfilled, a purchaser will be protected in the honest assumption that the bonds were validly and regularly issued.¹ And it is not necessary that the bonds should specifically recite the performance of the conditions, if general language is used—*e. g.*, to the effect that the bonds were issued in pursuance of the statute—whence purchasers may reasonably infer that the conditions precedent were fulfilled, and if nothing appears on the face of the bonds indicating any violation of the statute or departure from the authority conferred by it.²

§ 330. *Knox County v. Aspinwall*³ is authority for the proposition that from the mere issue of bonds with a recital that they were issued in pursuance of the statute, a purchaser might assume that the conditions on which the county was authorized to issue them had been complied with. This proposition has

¹ It will be noticed that the validity of municipal bonds depends not on principles of the law of negotiable paper alone. Their validity also rests, especially when they contain recitals, on the rule, for which *New York and New Haven R. R. Co. v. Schuyler*, 34 N. Y. 30, is a leading authority, that when the authority of an agent to act depends on the existence of a condition of fact peculiarly within his knowledge, and he certifies to the existence of that condition, either expressly, or impliedly, by acting in the matter, the principal (corporation) will be bound to the persons dealing with the agent in good faith, although the condition of fact does not exist. §§ 205–207.

² *Commissioners of Knox County v. Aspinwall*, 21 How. 539, in which case the bonds recited as follows: “This bond is issued in part payment of a subscription of 200,000 dollars by the said Knox County to the capital stock, etc., by order of the board of commissioners, in pursuance of the third section of the act, etc., passed by the

General Assembly of the State of Indiana, and approved 15th January, 1849.” See also *Kenicott v. Supervisors*, 16 Wall. 452; *St. Joseph Township v. Rogers*, 16 Wall. 644; *Marcy v. Township of Oswego*, 92 U. S. 638; *Humboldt Township v. Long*, 92 U. S. 642; *Commissioners, etc. v. Bolles*, 94 U. S. 104; *Township of Rock Creek v. Strong*, 96 U. S. 271; *San Antonio v. Mehaffy*, 96 U. S. 312; *County of Warren v. Marcy*, 97 U. S. 96; *Nauvoo v. Ritter*, 97 U. S. 389; *Hackett v. Ottawa*, 99 U. S. 86; *Town of Weyanwega v. Ayling*, 99 U. S. 112; *Supervisors v. Galbraith*, 99 U. S. 214; *Brooklyn v. Insurance Co.*, 99 U. S. 362; *Block v. Commissioners*, 99 U. S. 686; *Pana v. Bowler*, 107 U. S. 529; *Oregon v. Jennings*, 119 U. S. 74; *Dodge v. County of Platte*, 16 Hun, 285; *Shurtleff v. Wiscasset*, 74 Me. 130; *Anderson County v. Houston & G. N. R. R. Co.*, 52 Tex. 228; compare *Jacksonville, etc. R. R. Co. v. Town of Virden*, 104 Ill. 339.

³ 21 How. 539.

been reaffirmed in the Supreme Court;¹ but it may be stated in a somewhat different and a more guarded form, in which form it is unquestionably the law of the Supreme Court. "Where legislative authority has been given to a municipality, or to its officers, to subscribe for the stock of a railroad company, and to issue municipal bonds in payment, but only on some precedent condition, such as a popular vote favoring the subscription, and where it may be gathered from the legislative enactment that the officers of the municipality were invested with power to decide whether the condition precedent has been complied with, their recital that it has been made in the bonds issued by them, and held by a *bona fide* purchaser, is conclusive of the fact and binding upon the municipality, for the recital is itself a decision of the fact by the appointed tribunal."²

§ 331. This last statement differs little in effect from the proposition for which *Knox v. Aspinwall* is authority; for officers who have authority upon the existence of certain facts or the fulfilment of certain conditions to perform certain acts, ordinarily have implied authority to certify to the existence of those facts or the fulfilment of the conditions, unless otherwise prescribed by the statute,³ of which every purchaser would be bound to take notice. As Justice Swayne said, in *Commissioners of Johnson County v. January*:⁴ "This act . . . authorized the commissioners to issue the bonds, when the require-

¹ *Mercer County v. Hacket*, 1 Wall. 83; *Moran v. Commrs. of Miami County*, 2 Black, 722, 732; *Supervisors v. Schenck*, 5 Wall. 772, 784; *Meyer v. City of Muscatine*, 1 Wall. 384.

² *Town of Coloma v. Eaves*, 92 U. S. 484, 491; opinion of the court per Strong, J., acc. *Town of Venice v. Murdock*, 92 U. S. 494; *Anderson County Commrs. v. Beal*, 113 U. S. 227; contra, *Cogwin v. Town of Hancock*, 84 N. Y. 532.

See also *Pompton v. Cooper Union*, 101 U. S. 196; *Bonham v. Needles*, 103 U. S. 648; *Walnut v. Wade*, ib. 683; *County of Clay v. Society for*

Savings, 104 U. S. 579; *Insurance Co. v. Bruce*, 105 U. S. 328; *Grenada County Supervisors v. Brogden*, 112 U. S. 261; *County of Ralls v. Douglass*, ib. 728; *Lewis v. Commissioners*, ib. 739; *Dallas County v. McKenzie*, 110 U. S. 686.

³ See *Bissell v. Jeffersonville*, 24 How. 287; *Van Hostrup v. Madison City*, 1 Wall. 291; *Mercer County v. Hacket*, ib. 83; also §§ 205 *et seq.*

⁴ 94 U. S. 202, 205. The officer executing the bonds is sometimes expressly authorized to certify to the fulfilment of conditions precedent, as, *e. g.*, in *Lynde v. The County*, 16 Wall. 6.

ments of the law had been complied with. *They were thus constituted a tribunal for the adjustment of all questions touching the subject.* They were clothed with the power and charged with the duty to decide them. No appeal or review was provided for. Their issuing the bonds was the reflex and embodiment of their judgment that it was proper to do so.”¹

§ 332. Recent decisions of the Supreme Court of the United States, either deciding new points or interpreting former decisions, seem to place the following limitations or conditions on the operation of recitals in municipal bonds as estoppels. First: the recital will not conclude the municipality when from the face of the bond or from some record with notice of which the holder is affected, it appears that the statute authorizing the issue has not been complied with.² Thus, where a statute directs the county commissioners, when the electors shall have voted to issue bonds in aid of a railroad, to order the county clerk to make the subscription, and to cause the bonds to be issued in the name of the township, signed by the chairman of the board and attested by the clerk under the seal of the county, the signature of the clerk is essential to the valid execution of the bonds, even though he has no discretion to withhold it; and the town will not be estopped from disputing their validity by reason of recitals in the bonds to the effect that the terms of the statute have been complied with.³

¹ The municipality is estopped from setting up the non-fulfilment of a condition precedent “if certified to by the authorities whose primary duty is to ascertain it.” *Pana v. Bowler*, 107 U. S. 529.

² Of course no recital will conclude the municipality where there was no authority to issue the bonds; for every one is bound to take notice of the rule that municipal corporations have no implied authority to issue negotiable bonds, and also every one is bound to take notice of the terms of the legislative authority under which the bonds purport

to be issued. See §§ 319, 320. The Federal Supreme Court “has never intended to adjudge that mere recitals by the officers of a municipal corporation in bonds issued in aid of a railroad corporation precluded an inquiry, even where the rights of a *bona fide* holder were involved, as to the existence of legislative authority to issue them.” *Northern Bank v. Porter Township*, 110 U. S. 608, 615, opinion of Court per Harlan, J.

³ *Bissel v. Spring Valley Township*, 110 U. S. 162.

In another case, under the constitution and laws of Nebraska, a county had authority to issue bonds to the extent of ten per cent. of the assessed valuation of the property in the county. The bonds stated on their face that they were part of a series amounting in the aggregate to a specified sum, which exceeded ten per cent. of the assessed valuation of the property in the county, as any one could have ascertained by examining the assessment rolls on file. It was held that the officers issuing the bonds had no authority to conclude the county by a recital in the bonds to the contrary of what could thus have been ascertained.¹

Secondly : recitals in municipal bonds are conclusive only as far as they relate to facts within the authority of the officers making the recitals to determine and certify to the existence of.² "The adjudged cases, examined in the light of their special circumstances, show that the facts which a municipal corporation, issuing bonds in aid of the construction of a railroad, was not permitted, against a *bona fide* holder, to question, in face of a recital in the bonds of their existence, were those connected with or growing out of the discharge of the ordinary duties of such of its officers as were invested with authority to execute them, and which the statute conferring the power made it their duty to ascertain and determine before the bonds were issued ; not merely for themselves, as the ground of their own action in issuing the bonds, but, equally as authentic and final evidence of their existence, for the information and action of all others dealing with them in reference to it."³ Or, as Justice Matthews said, giving the opinion of the court in *Dixon County v. Field* : "Where the validity of the bonds depends on an estoppel claimed to arise upon the recitals of the instrument, the question being as to the existence of power to issue them, it is necessary to establish that the officers executing the bonds had lawful authority to make the recitals and to make them conclusive. The very ground of the estoppel is that the recitals

¹ *Dixon County v. Field*, 111 U. S. 83. See § 321. the court, per Harlan, J. Compare *Town of Springport v. Teutonia S'v'gs B'k*, 75 N. Y. 397 ; S. C., 84 N. Y.

² See §§ 330, 331.

³ *Northern Bank v. Porter Township*, 110 U. S. 608, 619, opinion of the court, per Harlan, J. Compare *Craig v. Town of Andes*, 93 N. Y. 405.

are the official statements of those to whom the law refers the public for authentic and final information on the subject.”¹

Thirdly: the recital or fact to be conclusive on the municipality must be the act of municipal officers empowered to certify to it, or to take final action in the matter, and not the act of some outside tribunal before whom the municipality has had no opportunity of appearing; or at least the fact or recital must be based on the action of such municipal officers. Thus, a statute provided that the holder of certain municipal bonds might have them registered in the office of the auditor of state, whose duty it should then be to notify the town officers issuing them, who in their turn should record the fact of the auditor’s registration; and the bonds should thereafter be considered registered bonds. The mere registration by the auditor, without further steps, was held ineffectual and not to estop the town.² Giving the opinion of the court, Justice Matthews said:

“If complete and conclusive effect were, on the contrary, given to the *ex parte* record of the auditor of state, as is claimed for it, the obvious design and just purpose of the statute would be not secured, but subverted; and municipal corporations might be subjected to liability for bonds purporting to be issued by them, which, in fact and in law, were not their obligations, by virtue of a proceeding of which they had no notice, resulting in an adjudication which they had no opportunity of contesting. A construction of the statute that necessarily leads to that conclusion is not warranted by its terms, and would be repugnant to fundamental principles of common right. If the registration of bonds issued under the act itself is to have the force of an adjudication by the auditor, the preliminary record by the officers of the municipal corporation transmitted to him must be the indispensable foundation of his jurisdiction, without which he cannot lawfully act; and as to

¹ 111 U. S. 83, 94.

² *Bissell v. Spring Valley Township*, 110 U. S. 162. The court said that it would have been otherwise, if the town officers had had to take the first steps, and then having registered

the bonds send a record of their proceedings to the auditor, who should do the final registration, and indorse it on the bonds; citing *Lewis v. Commissioners*, 105 U. S. 739.

bonds issued as were these now in suit, under previous statutes, the action of the auditor is itself but the preliminary proceeding, of which confirmation by the subsequent record of the officers issuing them is essential to its efficacy as a registration. If these officers refuse to recognize the registry of the auditor, whether rightfully or wrongfully, the holder loses no rights. He has the bonds as he acquired them, and may test the liability of the corporation by judicial proceedings. If, on the other hand, the statute is construed to allow him, by a proceeding before the auditor, conclusively to fix the liability of the municipal corporation, without notice and without a hearing, certainly, in respect to bonds previously issued, it would be open to the gravest objection on constitutional grounds, for, if a law cannot impair the obligation of a contract, neither can it create one, nor, by a mere *fiat*, take from a party an existing and meritorious defence.”¹

Fourthly: recitals will not estop the county from showing the invalidity of the bonds on grounds not properly covered by them. Thus, a recital in a municipal bond that it was “authorized by the following styled acts,” giving their titles and dates, does not estop the municipality from showing that the issue was not authorized by a two-thirds vote, as required by the state constitution.² In another case³ the bonds recited that they were “issued by the board of school directors by authority of an election of voters of said school district, held on the thirty-first day of July, 1869, in conformity with the provisions of chap. 98 of acts 12th general assembly of the state of Iowa.” The constitution of Iowa declares that no municipal corporation “shall be allowed to become indebted in any

¹ Bissell v. Spring Valley Township, 110 U. S. 162, 173.

When the constitution or a statute of a state requires as essential to the validity of municipal bonds that they shall be registered by the secretary and auditor of state, who shall also certify on them the fact that they have been issued according to law, yet does not give any conclusive effect to such registration or certificate, the municipi-

pality is not concluded by the certificate from denying the facts certified to; Dixon County v. Field, 111 U. S. 83; see also Crow v. Oxford, 119 U. S. 215. Compare Hoff v. Jasper County, 110 U. S. 53.

² Carroll County v. Smith, 111 U. S. 556. Compare § 329 and authorities cited in the last note to it.

³ School District v. Stone, 106 U. S. 183.

manner, or for any purpose, to an amount in the aggregate exceeding five per centum of the value of the taxable property within such county or corporation, to be ascertained by the last state and county tax lists, previous to the increasing of such indebtedness." The court held that the recital above mentioned "necessarily implied nothing more than that the bonds were issued by authority of the electors, and that the election was held in conformity with the statute. The statute may have been pursued as to the notice required to be given of the time and place of the election, and as to the manner in which the will of the voters was to be ascertained, and yet it may have been disregarded in respect to the limit it imposes upon district indebtedness. The declaration, therefore, that the election was held in conformity with the statute, does not with sufficient distinctness imply that the indebtedness voted was less than five per cent. on the value of the taxable property of the district, as shown by the state and county tax lists." Accordingly, the bonds, having been issued in excess of the constitutional limit, were held void. The court concluded with saying, that "where the holder relies for protection upon mere recitals, they should, at least, be clear and unambiguous, in order to estop a municipal corporation, in whose name such bonds have been made, from showing that they were issued in violation, or without authority of law."¹

§ 333. If not restrained by some valid special limitation upon the exercise of its taxing power, a county authorized to contract an extraordinary indebtedness by the issue of negotiable securities, may levy a tax to meet principal and interest as they accrue.² And when a state has authorized a municipal corporation to contract, and to exercise the power of local taxation to the extent necessary to meet its engagements, the power of taxation thus given cannot be withdrawn until the contract is satisfied. The state and the corporation are equally bound to respect the claims of the creditors of the latter; and the power given becomes a trust which

¹ 106 U. S. 187. Compare with ² Ralls County Court v. United States, 105 U. S. 733; Quincy v. Oswego, 92 U. S. 637, and see § 321. Jackson, 113 U. S. 332.

the donor cannot annul and the donee is bound to execute. "By the obligation of a contract is meant the means which, at the time of its creation, the law affords for its enforcement. The usual mode by which municipal bodies obtain the funds to meet their pecuniary engagements is taxation. Accordingly, when a contract is made upon the faith that taxes will be levied, legislation repealing or modifying the taxing power of the corporation, so as to deprive the holder of the contract of all adequate and efficacious remedy, is within the constitutional inhibition."¹ Accordingly, a *mandamus* will issue to a municipal corporation commanding it to levy taxes to the amount requisite to meet its valid engagements.² It is well established that after judgment at law for a sum of money against a municipal corporation and the return of execution unsatisfied, *mandamus*, not a bill in equity,³ is the proper mode to compel the levy of a tax which the corporation is bound to levy to pay the judgment.⁴ And when judgment has been duly obtained against a county on its bonds or coupons, no defence questioning their validity can be pleaded to a *mandamus*.⁵ Conversely, when in an action for a

¹ *Nelson v. St. Martin's Parish*, 111 U. S. 716, 721; op'n per Field, J. And see *Seibert v. Lewis*, 122 U. S. 284, and cases in next note.

² *Von Hoffman v. City of Quincy*, 4 Wall. 535; *United States v. New Orleans*, 98 U. S. 381; *Brodie v. McCabe*, 33 Ark. 690; *Columbia County v. King*, 13 Fla. 451. As long as a city exists laws are void which withdraw or restrict her taxing power so as to impair the obligation of her contracts made upon a pledge expressly or impliedly given that it shall be exercised for their fulfilment. *Mandamus* will lie, notwithstanding such laws. *Wolff v. New Orleans*, 103 U. S. 358, approving *Von Hoffman v. Quincy*. Compare *Louisiana v. Mayor of New Orleans*, 109 U. S. 285; *Rahway v. Munday*, 44 N. J. L. 395. Where the relator has a judgment, on

railway aid bonds, against a township, and is otherwise entitled to a writ of *mandamus*, a *mandamus* to compel the levy of a tax lies against all the officers whose co-operation in tax levies is by law required, whether they are town or county officers. *Labette County Commissioners v. Moulton*, 112 U. S. 217. But judgment on the bonds must first have been had. *Davenport v. County of Dodge*, 105 U. S. 237; *County of Greene v. Daniel*, 102 U. S. 187. Regarding *mandamus* as a remedy of the holder of municipal bonds, see *Dillon on Mun. Corps.*, 3d ed., §§ 849 *et seq.*

³ *Thompson v. Allen County*, 115 U. S. 550.

⁴ *Walkley v. City of Muscatine*, 6 Wall. 481.

⁵ *Ralls County Court v. United States*, 105 U. S. 733. Compare

mandamus a judgment is rendered against the relator on the ground that the bonds are invalid, that judgment is conclusive of their invalidity as against the vendee of the relator who purchases the bonds after maturity.¹ If a municipality by the statute authorizing the issue of bonds receives power to levy taxes to a certain amount, the implication arises that the legislature did not intend to authorize taxation beyond that amount, and a court has no power by *mandamus* to compel a municipal corporation to levy a tax unauthorized by law; nor to compel it to levy a larger tax than is authorized expressly or by implication.² A *mandamus* can only enforce existing laws; it confers no new power on those to whom it issues.³

§ 334. Property held for public uses, such as public buildings, squares, parks, promenades, wharves, landing-places, fire-engines, hose and hose-carriages, engine-houses, engineering instruments, and generally everything held for governmental purposes, cannot be subjected to the payment of the debts of the municipality. The public character of such property forbids this. Upon the repeal of the charter of the city, such property passes under the im-

Municipal
property
exempt
from exe-
cution.

State v. Mayor of Manitowoc, 52 Wis. 423.

A county subscribed for the stock of a railroad corporation, and issued bonds in payment therefor pursuant to a law that authorized the levy of a special tax to pay them, "not to exceed one-twentieth of one per cent. upon the assessed value of taxable property for each year," but which contained no provision that only the fund so derived should be applied to their payment. *Held*, that the bonds were debts of the county as fully as any other of its liabilities, and that for any balance remaining due on account of principal or interest after the application thereto of the proceeds of such tax, the holders were entitled to payment out of the general funds of the county. *United States v. County of Clark*, 96 U. S. 211; *Knox County v.*

United States, 109 U. S. 229. Compare *East St. Louis v. Zebley*, 110 U. S. 321. *Contra*, *State v. Macon County*, 68 Mo. 29. When the relator has obtained judgment on county bonds issued in aid of a railroad, and his only means of obtaining satisfaction is through the levy of a tax, a *mandamus* from a Federal court to the county officers directing them to levy a tax to pay the interest on the bonds, can in no way be controlled by an injunction from a state court enjoining a levy. *Supervisors v. Durant*, 9 Wall. 415; *Hawley v. Fairbanks*, 108 U. S. 543.

¹ *Louis v. Brown Township*, 109 U. S. 162.

² *United States v. County of Macon*, 99 U. S. 582. See *Quincy v. Jackson*, 113 U. S. 332, 338.

³ *United States v. County of Clark*, 95 U. S. 769.

diate control of the state, the power once delegated to the city in that behalf having been withdrawn ; neither can the private property of individuals within the limits of the territory of the city be subjected to the payment of its debts, except through taxation. The doctrine of some states that such property can be reached directly on execution against the municipality has not been generally accepted.¹

¹ *Merriweather v. Garrett*, 102 U. S. 472 ; *Darling v. Mayor, etc. of Baltimore*, 51 Md. 2. In towns in Connecticut (as in Massachusetts and Maine), the property of any inhabitant may, by common law or immemorial usage, be taken on execution upon a judgment against the town. *Bloomfield v. Charter Oak Bank*, 121 U. S. 121.

PART IV.

LIABILITY OF A CORPORATION FOR THE TORTS OF ITS AGENTS AND SERVANTS.

Corporations liable like natural principals. Grounds of the principal's liability, § 335.	Carrier's fundamental obligations, § 350.
An underlying principle. Application of the doctrines of <i>ultra vires</i> , §§ 336-338.	Modification of carrier's common law liability, § 351.
Liability when corporation is under no special obligation to the injured person, § 339.	Carrier cannot stipulate against liability for negligence, §§ 352-354.
Corporations also liable for torts on principles rendering them liable for contracts, § 340.	Carrier's liability for baggage, § 355.
Summary. Rules, § 341.	Limitations of carrier's liability in amount, § 356.
First rule. Liability resting on agent's authority, § 342.	Telegraph companies, § 357.
Second rule. Liability resting on course of tort-feasor's employment, §§ 343, 344.	Evidence of assent to limitations of carrier's liability, §§ 358, 359.
Third rule. Liability where tort causes violation of duty owed by the corporation, § 345.	When carrier's liability begins and ceases, § 360.
Violation of special obligation, § 346.	Delay in transportation, § 361.
Common carriers of passengers, § 347.	Carrier's liability for losses on connecting lines, §§ 362-364.
May make reasonable regulations, § 348.	Corporation's liability for injuries to employes, §§ 365, 366.
Liability of carriers for negligence, § 349.	Liability of corporation where it owes no special duty, § 367.
	Railroad companies, §§ 368, 369.
	Liability when lessened, § 370.
	Trespassers, §§ 371, 372.
	Contributory negligence, §§ 373-375.
	Burden of proof, § 376.
	Damages recoverable. Exemplary damages, §§ 377, 378.

§ 335. It may be stated as a general rule that corporations are responsible¹ for the torts² of their agents and servants upon

¹ That is to say, legal relations occasioned by the tort will subsist between the injured person and the corporation.

² A tort is a fact with legal effect,

other than a contract or agreement; a fact, that is, which occasions legal rules to manifest themselves in legal relations. Such fact may consist in an act or in an omission.

the same grounds and to the same extent as individual principals or masters.¹ The liability of principals or masters for the torts of their agents or servants does not rest in every respect on the rules which constitute the basis of the responsibility of principals for the contracts of their agents. The liability of a principal for the contract of his agent depends altogether on whether the contract was within the scope of the agent's actual authority, or of such authority as the other contracting party acting as a careful and honest man was justified in inferring to exist from the course and general scope of the agent's employment. But in regard to the principal's liability on the contract of his agent, the course and scope of the agent's employment are material only in determining whether the other contracting party was justified in relying on the agent's assumed authority. On the other hand, in regard to the principal's liability for the torts of his agent or servant, the course and scope of the employment become material in themselves, apart from their materiality as evidence of implied authority: for a principal may be liable for torts of his employé, committed in the course of the latter's employment, which the injured person could never have imagined that the principal had authorized. Thus, in *Craker v. Chicago and Northwestern Railway Co.*,² a railroad company was held liable to pay damages to a young lady passenger whom the conductor kissed; a tort which she was not justified in supposing to have been committed pursuant to instructions from the company. It might, indeed, be suggested that kissing passengers was not properly within the scope of the conductor's employment; but it is within the scope of his employment and duty to protect them from insult; and if he violates this duty by insulting them himself, the company will

Corporations liable like natural principals. Grounds of the principal's liability.

¹ *Philadelphia, etc. R. R. Co. v. Quigley*, 21 How. 202, 209; *Fishkill Savings Ins'n v. National Bank*, 80 N. Y. 162; *Denver and R. G. Ry. v. Harris*, 122 U.S. 597; *Angell and Ames on Corp.* § 310. See *Ramsden v. Boston and Albany R. Co.*, 104 Mass. 117; *Brokaw v. N. J. R. Co.*, 32 N. J. L. 328; *South and North Alabama R. R. Co. v. Chappell*, 61 Ala. 527; *Merchants' Bank v. State Bank*, 10 Wall. 645; *Salt Lake City v. Hollister*, 118 U. S. 256; *Ranger v. Great Western R'y Co.*, 5 H. L. C. 72, 86.

² 36 Wis. 657.

be responsible. For a railroad company is responsible to passengers even for the wilful and malicious acts of its conductors and train hands committed while they are employed in carrying out the contract between the passenger and the company.¹

§ 336. An underlying principle here is this: if the corporation, acting within the scope of its corporate authority, employs agents or servants in such a manner as to put it within their power to cause a violation of a duty owed by the corporation, the corporation will not be sustained in the defence that the violation complained of was not authorized by it. And thus it is, if the tort was committed in the course of an employment, or in connection with transactions which the corporation had competently authorized or acquiesced in, and any duty owed by the corporation is violated by the tort, it will be no valid defence to the corporation that the tort itself was not only unauthorized, but was even *ultra vires* the corporation. To the tort itself, under such circumstances, the doctrines of *ultra vires* have no application; but they do apply where the employment in the course of which, or the transaction in connection with which the tort was committed, was *ultra vires* the corporation.

Ordinarily, to render a corporation liable for the torts of its officers, agents, or employes, it must appear that the tort was in some way connected with the business which the corporation was incorporated to carry on;² and a corporation will not be liable for a tort committed in the course of a transaction clearly *ultra vires*;³ unless on principles of acquiescence and ratification heretofore discussed.⁴

§ 337. It has been frequently said that "corporations are liable for every wrong they commit, and in such cases the doc-

¹ *Stewart v. Brooklyn and Cross-town R. R. Co.*, 90 N. Y. 588. Accordingly, that the tortious act of the employe was done in direct violation of orders, will not exonerate the corporation. *Phila. and Reading R. R. Co. v. Derby*, 14 How. 468. § 347.

² *Miller v. Burlington, etc. R. R. Co.*, 8 Neb. 219. Compare *Helfrich v. Williams*, 84 Ind. 553.

³ *Central R. R., etc. Co. v. Smith*, 76 Ala. 572. A national bank is not authorized to engage in the business of selling railroad bonds on commission; and consequently is not liable in an action for deceit for the false statements of its teller made while selling such bonds. *Weckler v. First Nat. B'k*, 42 Md. 581.

⁴ See § 269.

trine of *ultra vires* has no application."¹ This phrase contains endless ambiguities. In both the cases cited in the note, the remark was unnecessary, if not inapplicable, to the decision of the case. In *Merchants' Bank v. State Bank*,² whatever wrong was committed, was committed by the cashier in the course of what the court decided the injured party was entitled to regard as the scope of the cashier's employment and authority. In *National Bank v. Graham* the bank was sued for the loss of a special deposit occurring through the gross negligence of its officers and employes. All the stock was owned by the directors, who knew of the receipt of the special deposit, and had acquiesced in it for years, and the court said, "it is now well settled that if a bank be accustomed to take such deposits as the one here in question, and this is known and acquiesced in by the directors, and the property is lost by the gross carelessness of the bailee, a liability ensues in like manner as if the deposit had been authorized by the terms of the charter."³ And to clinch the irrelevancy of the dictum, the court held that the bank was authorized by its charter to receive the deposit.⁴

§ 338. An exposure of the ambiguities or inaccuracies of the phrase above mentioned may be found in an opinion where a similar phrase is used. "A corporation is liable to the same extent, and under the same circumstances, as a natural person for the consequences of its wrongful acts, and will be held to respond in a civil action at the suit of an injured party for every grade and description of forcible, malicious, or negligent tort or wrong which it commits, however foreign to its nature or beyond its granted powers the wrongful transaction or act

¹ *National Bank v. Graham*, 100 U. S. 699, 702; *Merchants' Bank v. State Bank*, 10 Wall. 604, 645.

² See § 243 for a fuller statement of this case.

³ Citing *Foster v. Essex Bank*, 17 Mass. 479; *Lancaster County Nat. B'k v. Smith*, 62 Pa. St. 47; *Scott v. Nat. B'k of Chester Valley*, 72 Pa. St. 471; *First Nat. B'k v. Graham*, 79 Pa. St. 106; *Turner v. First Nat. Bank*, 26 Iowa, 562; *Smith v. First Nat. B'k*,

99 Mass. 605; *Chattahoochee Nat. B'k v. Schley*, 58 Ga. 369. Contra, *Wiley v. First Nat. B'k*, 47 Vt. 546; *Whitney v. First Nat. B'k*, 50 Vt. 389. See § 161.

⁴ It might seem improper to pick out a general phrase in an opinion, and criticise it by itself, without reference to the connection in which it is used. But here the criticism is on the general phrase itself in any connection.

may be.¹ . . . But in this case the false certificates were issued and the spurious stock transferred by an officer of the corporation. A corporation aggregate being an artificial body—an imaginary person of the law, so to speak—is, from its nature, incapable of doing any act except through agents to

¹ New York and New Haven R. R. Co. v. Schuyler, 34 N. Y. 30, 49, citing the following cases, not one of which sustains the proposition asserted: Life and Fire Ins. Co. v. Mechanic Fire Ins. Co., 7 Wend. 31, which held that a corporation authorized to loan on bond and mortgage could not recover money loaned in any other way [?]; and that when an illegal loan is made by the officers of the corporation who have power to loan for it, the company is affected with the illegality of the transaction. Albert v. Savings Bank, 2 Md. 169, a case where, in violation of a prohibition in its charter, a savings bank made a loan to one of its directors on the security of stock which the borrower held in a fiduciary capacity. The suit was brought by the *cestui que trust* to set aside the transfer to the bank, and recover the dividends received by it. The court said that any loan made to a director was void, and could not be recovered (on this point this case seems overruled in Lester v. Howard Bank, 33 Md. 558). It will be noticed that the suit was brought to set aside an illegal transaction arising out of the abuse of a general power conferred on the bank, a transaction which, though illegal, was clearly connected with the ordinary course of the bank's business; and certainly was not a transaction "foreign to the nature" of the bank Goodspeed v. East Haddam Bank, 22 Conn. 530, 541, a case where a bank was held liable for a vexatious suit instituted by

its directors. But it is clearly within the province of directors to institute suits on behalf of their bank, and so this was but the abuse of a general power confided to an agent. Bissell v. Mich. So., etc. Railroad Cos., 22 N. Y. 305, 309, a case referred to elsewhere, §§ 275, 290. In this case Judge Selden did hold the contract *ultra vires* and incapable of sustaining an action, but that plaintiff could recover on the ground of tort, on account of the "duty to observe care" which "in these cases arises, not upon any contract, but from the obligation which rests upon all persons, whether natural or artificial, so to conduct as not through their negligence to inflict injury on others." But to this it may be said that, except as the persons interested in the corporate enterprise acquiesced in the transactions in the course of which the tort was committed, and so were estopped from objecting, they owed the plaintiff no duty which would give him any right to funds in which they had rights. Frankfort Bank v. Johnson, 24 Me. 490. In this case the officers were acting within the general scope of their powers. Philadelphia, etc. R. R. Co. v. Quigley, 21 How. 209. Here, also, the officers were acting within the scope of their employment. Green v. London Omnibus Co., 7 C. B. N. S. 290. And in this case, too, the acts were connected with the objects of incorporation, and done in the course of the employment of the servant.

whom is given by its fundamental law, or in pursuance of it, every power of action it is capable of possessing or exercising. Hence the rule has been established . . . that a corporation is responsible for the acts or negligence of its agents while engaged in the business of the agency, to the same extent, and under the same circumstances, that a natural person is chargeable with the acts and negligence of his agent."¹

Granted that a corporation is liable to the same extent as a natural person for the torts of its agents. Nevertheless, it is not liable for any tort they may commit, however foreign to the nature of the corporate business the tort may be.² But, say the court, a corporation can act only through agents. Truly: and the binding quality of the acts of the body corporate itself acting as such, *i. e.*, through a majority vote, is determined by a construction of its powers and the principles of agency. Assuredly there exists no universal agency in the corporation which will render *any* act of the majority binding. Accordingly, to hold the corporation liable for any wrong it might authorize would be to hold the corporate funds, in which are interested dissenting shareholders and innocent creditors, bound by the acts of an agent (*i. e.*, the majority) clearly beyond the scope of his authority and business: a liability far beyond that attaching to individuals for the acts of their agents. There is no *decision* known to the writer holding a corporation liable for a tort committed in the course of an *ultra vires* transaction on its face foreign to the corporate business, where the persons who could have objected to the transaction had not acquiesced in it.³

As before stated, the question is not whether the wrongful act itself was *ultra vires*; any more than the question would be whether the act itself had been authorized by the corporation.⁴

¹ 34 N. Y. 50. The point decided in this case was that the corporation was liable in damages to a *bona fide* holder of shares issued by the proper officer, but in excess of the amount limited by the charter. Undoubted law; but not calling for any statement like that contained in the first part of the citation.

² *Langan v. Iowa*, etc. Construction Co., 49 Iowa, 317, § 342, note 1.

³ There seems to be no reason to suppose, however, that all the individuals in any way implicated in the commission of the tort, would not be personally liable to the injured person.

⁴ See *Butler v. Watkins*, 13 Wall. 456.

The question is whether the employment or general transaction, in the course of which the tort was committed, was *ultra vires*; and if this is answered in the affirmative, the corporation should not be held liable for the act, except on principles of acquiescence and ratification of the employment or transaction which undoubtedly make the *decision* in the Bissell case correct.¹

§ 339. When the tort is committed by an employé on some person between whom and the corporation no contractual relations exist; so that the tort causes the violation of no special duty or obligation on the part of the corporation, its responsibility will be governed by the rule expressed as follows in the New York case of *Mott v. Consumers' Ice Co.*² "For the acts of

Liability
when cor-
poration is
under no
special
obligation
to the in-
jured per-
son.

¹ See § 275. Nothing in the Bissell case except the actual decision has the sanction of the court. *Hutchinson v. Western and Atlantic R. R. Co.*, 6 Heisk. (Tenn.) 634; *New York L. E. and W. Ry. Co. v. Haring*, 47 N. J. L. 137; *Gruber v. R. R. Co.*, 92 N. C. 1, are similar to the Bissell case, approve of the phrase objected to in the text, and were decided the same way. *Hood v. New York and New Haven R. R. Co.*, 22 Conn. 502, is contra.

In *Alexander v. Relfe*, 74 Mo. 495, 517, the language of Judge Davis in the Schuyler case, quoted above, is cited approvingly, and a suggestion made that a corporation is not answerable for *ultra vires* contracts, but is for *ultra vires* torts. The court refers to Cooley on Torts, 119. Judge Cooley, however, says nothing countenancing any such rule. He does say, a corporation "must, indeed, act through agents and officers; but if these undertake to do what the corporation is not empowered to do, their action cannot impose a liability on the corporation." And then Judge Cooley refers to *Weckler v. First Nat. Bk.*, 42 Md. 581, cited § 336, and goes on to qualify

the sentence quoted from him, giving a general view of the liability of a corporation for torts which in no way supports any proposition like that approved by the Missouri court.

"To fix the liability of a corporation for the tortious act of one of its employés, done in obedience to the commands of its officers, the act must be connected with the transaction of the business for which the company was incorporated. If the directors should order an agent to take a person out of his house and beat him, the corporation could not be held for the assault and battery; or if the directors of a banking company should purchase a steamboat, and engage in transporting passengers, the corporation would not be liable for the misfeasance or non-feasance of agents employed in that business. But if the directors of a corporation having power to hold lands, order an agent to enter on lands and take possession of them for the legitimate uses of the company, his entry, if unlawful, will be the trespass of the corporation." *Brokaw v. N. J. R., etc. Co.*, 32 N. J. L. 328, 332.

² 73 N. Y. 543, 547.

the servant, within the general scope of his employment, while engaged in his master's business, and done with a view to the furtherance of that business and the master's interest, the master will be responsible, whether the act be done negligently, wantonly, or even wilfully. . . . But if a servant goes outside of his employment, and without regard to his service, acting maliciously, or in order to effect some purpose of his own, wantonly commits a trespass, or causes damages to another, the master is not responsible; so that the inquiry is whether the wrongful act is in the course of the employment, or outside of it, and to accomplish a purpose foreign to it. In the latter case the relation of master and servant does not exist so as to hold the master for the act."¹

§ 340. So far as to the general liability of corporations for the torts of its agents, as based on principles not wholly applicable to a corporation's responsibility for its agent's contracts. It must not be inferred, however, that a corporation is not also liable for the torts of its agents and servants on principles which regulate its liability for its agent's contracts. For, subject to the qualification regarding *ultra vires* acts above mentioned, a corporation is liable for any tort which it authorizes expressly, or which is fairly within the general scope of the authority of the agents who do the wrongful act.

Corporations also liable for torts on principles rendering them liable for contracts.

§ 341. To sum up: a corporation will be responsible for the torts of its servants and agents, (1) if the corporation or corporate management acting within the scope of its powers, authorized or ratified the tort, or the tort was fairly within the scope of the tort-feasor's authority to act for the corporation; or (2) if the tort was committed in the course of the tort-feasor's employment by the corporation; or (3) if the tort occasioned a violation of any duty or obligation owed by the corporation to the injured person. And in applying the doctrines of *ultra vires* to the liability of corporations for the torts of their agents and servants, it must be remembered that those doctrines are never applicable to the actual tort;

Summary.
Rules.

¹ See also *Poulton v. London and Western R'y Co.*, L. R. 5 C. P. 445; *Southwestern R'y Co.*, L. R. 2 Q. B. 534; *Edwards v. London and North-western R'y Co.*, L. R. 6 Q. B. 65.

though they may operate to relieve a corporation from responsibility where the entire employment of the agent or servant, or the whole transaction in regard to which the tort was committed, is evidently *ultra vires*.

Illustrations will now be given of the three general rules.

§ 342. If the corporation or the corporate management acting within the scope of its powers authorized or ratified the tort, or if the tort was fairly within the scope of the agent's authority to act for the corporation, the latter will be responsible.¹

First rule.
Liability
resting on
agent's
authority.

This rule is applicable to the torts of officers and agents, rather than to those of the corporation's servants and employes. A corporation is liable for any fraud² committed by an agent in the course of a transaction in regard to which he actually has authority to act for the corporation, or where authority to act for it may be inferred from the course and scope of his position and employment.³ An action for deceit will lie

¹ A corporation is liable for an overpayment made by mistake to its general manager, he acting at the time in the course of his employment and authority. *Kansas Lumber Co. v. Central Bank*, 34 Kan. 635.

² A corporation may be in a legal sense guilty of a fraud, and in such case ordinary rules permitting rescission of contracts induced by fraud, and reclamation of property when the owner has been induced to part with it through fraud, apply in favor of persons dealing with the corporation. *Cragie v. Hadley*, 99 N. Y. 131.

³ *Butler v. Watkins*, 13 Wall. 456; *Lamm v. Port Deposit Homestead Assn.*, 49 Md. 233; *Scofield Rolling Mill Co. v. Georgia*, 54 Ga. 635; *Bank of Greensboro v. Clapp*, 76 N. C. 482; *Mackay v. Commercial Bank*, L. R. 5 P. C. 394; *Hunter v. Hudson River Iron Co.*, 20 Barb. 507; *New York and N. H. R. R. Co. v. Schuyler*, 34 N. Y. 30; *Erie City Iron Works v. Barber* 106 Pa. St. 125; *Western*

Maryland R. R. Co. v. Franklin Bank, 60 Md. 36; *Shaw v. Port Philip*, etc. *M'g Co.*, 132 B. Div. 603.

"It is urged that a corporation will not be affected by any representation made by an agent, unless the agent was directly authorized to make the particular statement. The principal is liable for the false representations of the agent made in and about the matter for which he was appointed agent, not on the ground of express authority given to the agent to make the statement, but on the ground that as to the particular matter for which the agent is appointed he stands in the place of the principal, and whatever he does or says in or about that matter is the act or declaration of the principal, for which the principal is just as liable as if he had personally done the act or made the declaration." *Sharp v. Mayor*, etc. of New York, 40 Barb. 256, 273.

A bank cannot set up the fraud of its own officers to a demand by a de-

against a corporation,¹ or an action of trover for conversion.² So a corporation will be liable in damages for the publication of a libel by its agents,³ unless the libel and the matter to which

positor for repayment. *Steckel v. First Nat. Bk.*, 93 Pa. St. 376; *Ziegler v. Same*, ib. 393; *Citizens' Savings Bank v. Blakesley*, 42 O. St. 645. Compare *First Nat. Bank v. Williams*, 100 Pa. St. 123; *Lewis v. Meier*, 4 McCrary, 286; *Commonwealth v. Reading Savings Bank*, 137 Mass. 431. Defendant borrowed six thousand dollars from a bank and deposited collaterals, which the president of the bank converted to his own use. The bank trustees appeared to have been negligent in inspecting its securities, and the president had charge of the collaterals. *Held*, that the receiver of the bank could not recover without allowing defendant the value of his collaterals. *Cutting v. Marlor*, 17 Hun, 573; see *Williamson v. Mason*, 12 Hun, 97. Compare *Barksdale v. Finney*, 14 Gratt. (Va.) 338; *Commonwealth v. Reading Savings Bk.*, 133 Mass. 16.

But officers cannot render the corporation liable for fraudulent misrepresentations regarding matters not connected with the corporation. Thus, where one company becomes a shareholder in another, the officers of the former have no authority to make representations as to the pecuniary condition of the latter, so as to render the former company liable, although the representations be fraudulent and untrue. *Langan v. Iowa, etc. Construction Co.*, 49 Iowa, 317.

¹ *Peebles v. Patapsco Guano Co.*, 77 N. C. 233. But compare *Western Bank of Scotland v. Addie*, L. R. 1 H. L. Sc. 145, 157.

The fraudulent representations of the corporate agent may also give the

other party the right to annul the contract. *McClellan v. Scott*, 24 Wis. 81; *Derrick v. Lamar Ins. Co.*, 74 Ill. 404; *Henderson v. Railroad Co.*, 17 Tex. 560; *Wickham v. Grant*, 28 Kan. 517. As to the avoidance of a contract to take shares on account of the fraud of the corporate agent, see §§ 523-526.

² *Beach v. Fulton Bank*, 7 Cow. (N. Y.) 485.

³ *Philadelphia, etc. R. R. Co. v. Quigley*, 21 How. 202; *Vance v. Erie R. Co.*, 3 Vroom (N. J.), 334; *McDermott v. Evening Journal*, 43 N. J. L. 488; S. C., 44 N. J. L. 430; *Maynard v. Fireman's Fund Ins. Co.*, 34 Cal. 48; S. C., 47 Cal. 207; *Vinas v. Merchants' Mut. Ins. Co.*, 27 La. Ann. 367; *Howe Machine Co. v. Souder*, 58 Ga. 64; *Fenton v. Wilson Sewing Machine Co.*, 9 Phila. 189; *Bacon v. Michigan Central R. R. Co.*, 55 Mich. 224; *Boogher v. Life Association*, 75 Mo. 319 (overruling *Gillett v. Missouri Valley R. R. Co.*, 55 Mo. 315, and *semble Childs v. Bank of Missouri*, 17 Mo. 213); *Johnson v. St. Louis Dispatch Co.*, 2 Mo. App. 565.

The communications of an officer to the members of the corporation in the course of his duty are privileged. But this privilege does not extend to the presentation of a report and evidence in the permanent form of a book for distribution among the persons belonging to the corporation, and members of the community. Exemplary damages, however, should not be allowed when there is no evidence of malice. *Philadelphia, etc. R. R. Co. v. Quigley*, 21

it related were beyond the scope of the express and implied authority of the agents. In which case it will not be liable.¹ Likewise an action for false imprisonment,² or for malicious prosecution will lie against a corporation, provided the prosecution was authorized or ratified by the corporation, or was instituted by some officer or agent acting within the scope of his authority or the course of his employment.³

§ 343. The second rule—that the corporation is responsible for a tort committed in the course of the tort-feasor's employment by the corporation—is of a tenor similar to that of the first rule, but applies to the torts of employes and servants, rather than to those of officers and agents. Employes and servants have, properly speaking, no authority to represent the corporation or to contract for it. Hence, the course of their employment is all-important in determining the liability of the corporation for their torts.

§ 344. A corporation, as for instance, a railroad company, is liable for the assaults and batteries,⁴ and trespasses⁵ of its servants committed while acting within the general scope of their employment in the business of the corporation; or for a public nuisance created by them under like circumstances.⁶ And the circumstance that the act of the servant was wilful, will not, in itself, preclude the liability of the corporation.⁷ But the as-

How. 202. On the question of privilege, see also *Lawless v. Anglo-Egyptian Co.*, L. R. 4 Q. B. 262.

¹ *Southern Express Co. v. Fitzner*, 59 Miss. 581.

² *Lynch v. Metropolitan Elevated R. R. Co.*, 90 N. Y. 77.

³ *Williams v. Planter's Ins. Co.*, 57 Miss. 759; *Reed v. Home Savings Bank*, 130 Mass. 443; *Woodward v. St. Louis, etc. Ry. Co.*, 85 Mo. 142; *Wheeler & Wilson M'fg Co. v. Boyce*, 36 Kan. 350; *Copley v. Grover & Baker Sewing Machine Co.*, 2 Woods, 494; *Carter v. Howe Machine Co.*, 51 Md. 290; *Jordan v. Alabama, G. S. R. R. Co.*, 74 Ala. 85, overruling *Owsley v. Montgomery, etc. R. R.*

Co., 37 Ala. 560; and *South and North Ala. R. R. Co. v. Chappell*, 61 Ala. 527; see *Ricord v. Central Pac. R. R. Co.*, 15 Nev. 167; *Goodspeed v. East Haddam Bank*, 22 Conn. 530; *Wheless v. Second Nat. Bk.*, 1 Baxt. (Tenn.) 469.

⁴ *Hewitt v. Swift*, 3 Allen, 420; *Holmes v. Wakefield*, 12 Allen, 580. See §§ 347, 348.

⁵ *Whiteman's Exr. v. Wilmington, etc. R. R. Co.*, 2 Harr. (Del.) 514; *Hazen v. Boston and Maine R. R. Co.*, 2 Gray, 574; *Mobile, etc. R. R. Co. v. McKellar*, 59 Ala. 458.

⁶ *Ford v. Santa Cruz R. R. Co.*, 59 Cal. 290.

⁷ *Mott v. Consumers' Ice Co.*, 73 N.

sault of the servants must in some way be connected with their employment in the business of the corporation. And thus it has been held that a railroad company is not liable for an assault and battery committed by its employés on a person who, they thought, had placed obstructions on the railroad track; the assault being in no way connected with their employment.¹

§ 345. We come now to the consideration of the third rule regulating the liability of corporations for the torts of their servants and agents. A corporation is liable for any wrongful or negligent act or omission on the part of any of its servants or agents which causes a violation of any duty or obligation owed by the corporation to the injured person: and this is true whether the corporation owes to the injured person special duties arising from contract, so that the tort occasions a breach of contract; or whether it is a duty owed to the injured person merely as a member of the community; a duty mainly based on the maxim, *Sic utere tuo ut alienum non lædas*. It will be convenient to consider first, the liability of a corporation for the torts of its agents and employés which cause the breach of some special or contractual obligation owing from the corporation to the injured person. The illustrations will be almost entirely drawn from the law relating to common carriers, and in especial to railroad companies; but of course other classes of corporations will at times have to respond in damages for omissions and neglects of their servants and agents, which cause the breach of a duty owing from the corporation.

Third rule. Liability where tort causes violation of duty owed by corporation.

§ 346. Thus, a bank is liable for the loss, through the gross negligence of its officers or employés, of a special deposit re-

Y. 543; Nashville & C. R. R. Co. v. Starnes, 9 Heisk. (Tenn.) 52; Banister v. Pennsylvania Co., 98 Ind. 220. A railroad company is liable for the wilful acts of its servants in running a train over a person on the track. Terre Haute, etc. R. R. Co. v. Graham, 46 Ind. 239. Contra, Illinois Central R. R. Co. v. Downey, 18 Ill. 259; Pennsylvania Co. v. Toomey, 91 Pa. St. 256.

¹ Porter v. C. R. I. and P. R. R. Co., 41 Iowa, 358. See also Marion

v. C. R. I. and P. R. Co., 59 Iowa, 428. A railroad company is not responsible for the acts of its employés in creating a nuisance by using a culvert under its railroad, near the plaintiff's residence, as a privy. Hopkins v. Western Pac. R. R. Co., 50 Cal. 190. See also Edwards v. London and N. W. R'y Co., L. R. 5 C. P. 445; Allen v. London and S. W. R'y Co., L. R. 6 Q. B. 65; but compare Goff v. Great Northern R'y Co., 3 E. & E. 672.

ceived by it for safe keeping;¹ and for the neglect of its officers to protest or present at maturity a promissory note deposited with it for collection.² And a bank will be liable if its teller receives a deposit unaccompanied by the customary deposit ticket or pass-book, and credits it by mistake to the wrong person.³

Violation
of special
obligation.

§ 347. To the contract of a common carrier of passengers the law from motives of public policy adds certain implied covenants or obligations; or it may be said, in somewhat different words, the carrier impliedly agrees to do more than simply to carry the passenger. He agrees, as we shall hereafter see in regard to negligence, to use every reasonable precaution for the passenger's safety;⁴ and while a carrier does not insure his passengers against every conceivable danger, he is held absolutely to agree that his own servants engaged in transporting the passenger shall commit no wrongful act against him. Accordingly, any tort committed on a passenger by servants of the carrier who come in contact with him in the ordinary performance of their duties and labors, causes a breach of contract between the passenger and the carrier, for which the latter is liable. Recent cases state this liability in the broadest and strongest language; and, without going beyond the actual decisions, it may be said that the carrier is liable for every conceivable wrongful act done to a passenger by its train-hands and other employes while they are engaged in transporting him; no matter how wilful and malicious the act may be, or how plainly may be apparent from its nature that it could not have been done in furtherance of the carrier's business. The rule limiting the responsibility of the master to acts of his servants done within the scope of the servants' employment, does not apply to the relations between common carriers and passengers.⁵

¹ *National Bank v. Graham*, 100 U. S. 699; *Chattahoochee Nat. Bk. v. Schley*, 58 Ga. 369; §§ 161, 337.

³ *Jackson Ins. Co. v. Cross*, 9 Heisk. (Tenn.) 283.

⁴ See § 350.

² *Chapman v. McCrea*, 63 Ind. 360; *Bank of New Hanover v. Kenan*, 76 N. C. 340; *Steele v. Russell*, 5 Neb. 211; *Capital State Bank v. Lane*, 52 Miss. 677. See § 161.

⁵ *Stewart v. Brooklyn and Cross-town R. R. Co.*, 90 N. Y. 588 (practically overruling *Isaacs v. Third Av. R. R. Co.*, 47 N. Y. 122); *Pendleton v. Kinsley*, 3 Cliff. 416; *Goddard v.*

A carrier's liability extends even further. He is bound to use every endeavor to protect his passengers, as long as they are under his charge, from the assaults of persons other than his own servants, for instance, fellow-passengers. And if his servants fail to use their best endeavors to protect passengers, the carrier will be responsible.¹

§ 348. A carrier has the right to make reasonable regulations for the management and ordering of his business; and no cause of action will arise against him for the reasonable acts of his servants done in carrying out such regulations. But a regulation will be no protection to the carrier if it is unreasonable, or if his servants use undue force or violence in enforcing it.² A regulation by a

May make reasonable regulations.

Grand Trunk Railway, 57 Me. 202; *Bryant v. Rich*, 106 Mass. 180; *Chicago and Eastern R. R. Co. v. Flexman*, 103 Ill. 546; *Hanson v. European, etc. R. Co.*, 62 Me. 84; *Craker v. Chicago and N. W. R'y Co.*, 36 Wis. 657; *Passenger R. R. Co. v. Young*, 21 Ohio St. 518; *Terre Haute and I. R. R. Co. v. Jackson*, 81 Ind. 19; *Jeffersonville R. R. Co. v. Rogers*, 38 Ind. 116; *Indianapolis, P. and C. R. R. Co. v. Anthony*, 43 Ind. 183; *Terre Haute and I. R. R. Co. v. Fitzgerald*, 47 Ind. 79; *New Orleans, St. Louis, etc. R. R. Co. v. Burke*, 53 Miss. 201; *Nieto v. Clark*, 1 Cliff. 145; *Sherley v. Billings*, 8 Bush, (Ky.) 147; *Moore v. Fitchburg R. R. Co.*, 4 Gray, 465; compare *Perkins v. Missouri, K. and T. R. R. Co.*, 55 Nev. 201. But see *Allegheny R. R. Co. v. McLain*, 91 Pa. St. 442.

Co., 12 J. & Sp. (N. Y.) 8; *Britton v. Atlanta, etc. R'y Co.*, 88 N. C. 536; *New Orleans, St. L. and C. R. R. Co. v. Burke*, 53 Miss. 200; *Pittsburgh and C. R. R. Co. v. Pillow*, 76 Pa. St. 510; *Spohn v. Missouri Pac. R'y Co.*, 87 Mo. 74. See *Putnam v. Broadway, etc. R. R. Co.*, 55 N. Y. 108; *Barrett v. Malden, etc. R. R. Co.*, 3 Allen, 101.

It is said that sleeping-car companies are not liable either as inn-keepers or as common carriers for goods stolen from the person of an occupant of a berth in a sleeping-car. *Pullman Palace Car Co. v. Smith*, 73 Ill. 360. See *Welch v. Pullman Palace Car Co.*, 16 Abb. Pr. N. S. (N. Y.) 352, and cases below. But it is the duty of a sleeping-car company vigilantly to protect in their persons and property the occupants of berths when asleep; and the company is liable to them for goods stolen from their persons while asleep through want of care on its part and on the part of its servants. *Woodruff Sleeping, etc. Co. v. Diehl*, 84 Ind. 474.

¹ *Pittsburgh, Ft. W. and C. R'y Co. v. Hinds*, 53 Pa. St. 512; *Flint v. Norwich and N. Y. Trans'n Co.*, 34 Conn. 554; *Holly v. Atlanta Street R. R. Co.*, 61 Ga. 215 (a statute affected this decision); *Weeks v. N. Y., N. H. and H. R. R. Co.*, 72 N. Y. 50; *Hendricks v. Sixth Ave. R. R.*

² *Peck v. N. Y. C. and H. R. R. R. Co.*, 70 N. Y. 587; *Chicago, B. and*

railroad company setting apart in the first instance a car for females and their escorts, is proper and reasonable, and the company has a right to enforce it.¹ Likewise, in order to preserve order and prevent collisions from well-known race repugnances, a carrier may seat passengers according to color.² And gamblers and monte-men, who travel on a train to ply their vocation, may be excluded;³ or a person who is so drunk as to be offensive.⁴

A regulation by a railroad company requiring passengers to exhibit their tickets whenever requested by the conductor, and directing the ejection from the cars of those who refuse to comply, is reasonable and proper. A passenger is bound to comply, and by refusing forfeits his right to be carried farther.⁵ On the

Q. R. R. Co. v. Griffin, 68 Ill. 499; *Pennsylvania R. R. Co. v. Vandiver*, 42 Pa. St. 365; *Chicago, B. and Q. R. R. Co. v. Bryan*, 90 Ill. 126. A passenger should inform himself of the carrier's regulations. *McRae v. Wilmington, etc. R. R. Co.*, 88 N. C. 526; *Britton v. Atlanta, etc. R'y Co.*, ib. 536.

¹ *Peck v. N. Y. C. and H. R. R. Co.*, 70 N. Y. 587. So a regulation that no man, unaccompanied by a woman, shall enter the ladies' private room is reasonable. *Toledo, Wabash and W. R'y Co. v. Williams*, 77 Ill. 354. See also *McRae v. Wilmington, etc. R. R. Co.*, 88 N. C. 526.

² *West Chester, etc. R. R. Co. v. Miles*, 55 Pa. St. 209. See *Derry v. Lowry*, 6 Phila. 30. Changed by act of Pennsylvania legislature in 1867, and such a regulation would perhaps be unconstitutional since the 14th amendment to the Federal constitution. And see, as opposed to the Pennsylvania decisions, *Chicago and N. W. R'y Co. v. Williams*, 55 Ill. 185. A passenger must observe proper decorum and reasonable rules, and is not justified in resisting every trivial im-

position to which he may be exposed, so that his resistance must be overcome by counter-force to preserve subordination. *Chicago, B. and Q. R. R. Co. v. Griffin*, 68 Ill. 499.

³ *Thurston v. Union Pac. R. R. Co.*, 4 Dill. 321. See also *Pearson v. Duane*, 4 Wall. 605. A regulation forbidding hackmen, peddlers, expressmen, and loafers from coming within a passenger depot is reasonable. *Summitt v. State*, 8 Lea (Tenn.), 413.

⁴ *Pittsburgh, C. and St. L. R'y Co. v. Vandyne*, 57 Ind. 576. See *Railway Co. v. Valleley*, 32 O. St. 345; *Murphy v. Union R'y Co.*, 118 Mass. 228.

⁵ *Hibbard v. N. Y. and Erie R. R. Co.*, 15 N. Y. 455; *Crawford v. Cincinnati, etc. R. R. Co.*, 26 O. St. 580. Carriers may require passengers to purchase and show tickets. *Pullman Palace Car Co. v. Reed*, 75 Ill. 125; *Lane v. Railroad Co.*, 5 Lea (Tenn.), 124. A carrier may discriminate between the amount of fare when a ticket is purchased, and when the fare is paid on the train. *Swan v. Manchester, etc. R. R.*, 132 Mass. 116; *Indianapolis, etc. R. Co. v. Rinard*,

other hand, it is unreasonable to require that a passenger shall not leave the train or station without showing a ticket or paying his fare; and if in carrying out this regulation a passenger is detained or arrested by the employes of the carrier, the carrier will be liable for damages in a suit for false imprisonment.¹

§ 349. The most numerous and on that account the most important class of cases in which carriers are held liable for misfeasance of their employes which causes a breach of the carrier's obligations, are cases of negligence. And here we may consider, first, the responsibility of carriers for negligence towards persons to whom they owe some special duty,² and, secondly, their responsibility to persons towards whom they are affected only with the general duty arising under the maxim, *Sic utere tuo ut alienum non lædas*.

Liability of
carriers for
negligence.

46 Ind. 293; Toledo W. and W. R. R. Co. v. Wright, 68 Ind. 586; Du Laurens v. First Division St. P. and P. R. R., 15 Minn. 49; see Jeffersonville R. R. Co. v. Rogers, 38 Ind. 116. A regulation requiring stop-over tickets is reasonable. Yorton v. Milwaukee, etc. R'y Co., 54 Wis. 234; Stone v. C. and N. W. R. Co., 47 Iowa, 82. A regulation requiring the purchase of tickets before entering the cars is unreasonable, unless proper facilities for the purchase of tickets are furnished. Evans v. Memphis, etc. R. R. Co., 56 Ala. 246; Du Laurens v. First Division St. P. and P. R. R. Co., 15 Minn. 49; St. Louis, A. and C. R. R. Co. v. Dalby, 19 Ill. 353. Compare Thorpe v. New York C. and H. R. R. Co., 76 N. Y. 402.

¹ Lynch v. Metropolitan Elevated R'y Co., 90 N. Y. 77. Under such circumstances the carrier may have an action to recover the fare, but no right to arrest or imprison the passenger. *Ib.*

² In actions by passengers against railroad companies for personal inju-

ries caused by negligence, whether the action is in tort or on contract, the burden is on the plaintiff either to prove negligence of the company or show facts which raise a presumption of such negligence. Stokes v. Saltonstall, 13 Pet. 181. A passenger makes out a *prima facie* case by showing that he was injured through a defect in the road, in the cars, or in any portion of the apparatus used by the company in carrying passengers. Curtis v. Rochester, etc. R. R. Co., 18 N. Y. 534; Meier v. Pennsylvania R. R. Co., 64 Pa. St. 225; Pittsburgh C. and St. L. Ry. Co. v. Thompson, 56 Ill. 138; Toledo W. and N. R. R. Co. v. Beggs, 85 Ill. 80; George v. St. Louis, etc. Ry Co., 34 Ark. 613; Yonge v. Kinney, 28 Ga. 111; Higgins v. Hannibal and St. Jo. R. R. Co., 36 Mo. 418; Wilson v. Northern Pac. R. R. Co., 26 Minn. 278; Wall v. Livezey, 6 Col. 465; Railroad Co. v. Walrath, 38 O. St. 461; Pittsburgh C. and St. L. R. R. Co. v. Williams, 74 Ind. 462. Proving injury from a

§ 350. The primary or fundamental obligations and liabilities of a common carrier are imposed on him by law, on account of the nature of his employment; and do not arise exclusively from the expressed contract between the carrier and the person dealing with him; although these obligations may be modified and limited by contract.¹ The preceding proposition requires explanation,

When a common carrier is incorporated, the law, from motives of public policy, imposed on it certain duties. Its primary duty is to carry; and to carry whatever freight is offered, and whatever passengers present themselves, to the extent of its capacity.² Moreover, common carriers of freight are bound to take what goods are offered, and transport them safely, insuring them against all loss and damage except that arising from the act of God or of the public enemy,³ or from the

collision of trains raises *prima facie* presumption of negligence. *Iron R. R. Co. v. Mowery*, 36 O. St. 418; *New Orleans J. and G. N. R. R. Co. v. Allbritton*, 38 Miss. 242.

¹ *Hannibal R. R. Co. v. Swift*, 12 Wall. 262.

² A common carrier is bound to carry when called on, and to charge only a reasonable compensation. *Winona, etc. R. R. Co. v. Blake*, 94 U. S. 180. See § 309, note. In some States this is provided for by statute. But a carrier is not bound to allow a business interfering with his interest to be transacted on his vehicles; *e. g.*, he may refuse passage to an express agent who persists in transacting express business on his boat. *The D. R. Martin*, 11 Blatchf. 233; *Barney v. Oyster Bay Steamboat Co.*, 67 N. Y. 301. Railroad companies are not required by usage or by common law to transport the traffic of independent express companies in the manner in which such traffic is usually carried and handled. *Express Cases*, 117 U. S. 1. See

§ 309 and notes. Compare *Thurston v. Union Pac. R. R. Co.*, 4 Dill. 321, § 348.

³ *Propeller Niagara v. Cordes*, 21 How. 7; *Merritt v. Earle*, 29 N. Y. 115; *Colt v. McMeichen*, 6 Johns. (N. Y.), 160; *Fillobrown v. Grand Trunk R. Co.*, 55 Me. 462; *South and North Ala. R. R. Co. v. Wood*, 66 Ala. 167. A carrier is bound to use due diligence to prevent the destruction of goods by the act of God or the public enemy; and if his negligence occasions the loss of goods through one of these causes he is liable. *Holladay v. Kennard*, 12 Wall. 254; *Michaels v. N. Y. Central R. R. Co.*, 30 N. Y. 564; *Read v. Spalding*, *id.* 630; *Packard v. Taylor*, 35 Ark. 402; *Caldwell v. Southern Express Co.*, 1 Flip. C. Ct. 85; *Wallace v. Clayton*, 42 Ga. 443. Compare *Gillespie v. St. Louis, etc. R'y Co.*, 6 Mo. App. 554. Where liquors were shipped to Maine, and were there seized and destroyed under the Maine laws, the carrier was not held liable. *Wells v. Maine Steamship Co.*, 4 Cliff.

inherent damnyfying or perishable qualities of the goods themselves.¹ And a common carrier of passengers is bound to use every care and precaution for the safety of passengers carried by it.² This duty or obligation on the part of the carrier has its complement in a right on the part of the public and of every individual citizen; a right by comity extended to persons who are not citizens. In respect of carriers of goods this right of every person is to have carried whatever harmless and lawful goods he may offer for carriage,³ and to have them, during the carriage, insured by the carrier against all loss and damage, except such as may arise from one of the causes excepted above; and in respect of carriers of passengers it is the right of every one to be carried, and to have every precaution used to insure his personal safety during the passage. These rights do not depend on any specific agreement, but belong to every person placing himself

C. Ct. 228. But the carrier should immediately notify shipper of seizure. Ohio, etc. R. Co. v. Yohe, 51 Ind. 181.

¹ Illinois Central R. R. Co. v. McClellan, 54 Ill. 58.

² Philadelphia & Reading R. R. Co. v. Derby, 14 How. 468; Pennsylvania Co. v. Roy, 102 U. S. 451; McElroy v. Nashua and Lowell R. R. Co., 4 Cush. 400; Meier v. Pennsylvania R. R. Co., 64 Pa. St. 225; Louisville City R'y v. Weams, 80 Ky. 420; Brunswick, etc. R. R. Co. v. Gale, 56 Ga. 322; Kansas Pac. R'y Co. v. Miller, 2 Col. 442; Sherlock v. Alling, 44 Ind. 184; Gillenwater v. Madison, etc. R. R. Co., 5 Ind. 339; Indianapolis B. and W. R. Co. v. Beaver, 41 Ind. 493; Gilson v. Jackson County Horse R'y Co., 76 Mo. 282; Taylor v. Grand Trunk R'y Co., 48 N. H. 304; Chicago B. and Q. R. R. Co. v. George, 19 Ill. 510. The railroad company remains liable although the car in which the plaintiff was injured belonged to the Pullman Palace Car Co. v. Pennsylvania Co. v. Roy,

supra. The care which the carrier is bound to use is not affected by the fact that the person is travelling in a cattle train. Indianapolis, etc. R. R. Co. v. Horst, 93 U. S. 291. See Ohio & M. R. R. Co. v. Dickerson, 59 Ind. 317; Edgerton v. New York, etc. R. R. Co., 39 N. Y. 227; Dunn v. Grand Trunk Ry. Co., 58 Me. 187; Creed v. Pennsylvania R. R. Co., 86 Pa. St. 139. But see Player v. Burlington, etc. Ry. Co., 62 Iowa, 723. And it is no defence that the plaintiff, a passenger, was pregnant, and her injuries were due rather to her condition than to the accident. Sawyer v. Dulany, 30 Tex. 479.

³ Pittsburgh, Cincinnati, etc. R. Co. v. Morton, 61 Ind. 539; Chicago & A. R. R. Co. v. Erickson, 91 Ill. 613. See Western Un. Tel. Co. v. Ferguson, 57 Ind. 495; Evansville, etc. R. R. Co. v. Duncan, 28 Ind. 441, 446. Compare Pittsburgh, etc. R. Co. v. Hollowell, 65 Ind. 188; Phelps v. Illinois Central R. R. Co., 94 Ill. 548; Illinois Central R. R. Co. v. Cobb, 64 Ill. 128.

in regard to the carrier, in the position of shipper or passenger.¹ The contractual element in the causation of these rights is the voluntary act whereby a person places himself in such a position. That, without further stipulation, occasions them.

§ 351. These legal relations are as it were stereotyped; and from motives of public policy courts hold that without the consent of the person dealing with the carrier, they may not be materially varied;² and that even with his consent, certain modifications in them may not be made. With the consent of such person the carrier may stipulate that it shall not be responsible for losses arising from fire;³ and indeed for any loss not occasioned by its negligence or that of its employés.⁴

Modifica-
tions of
carrier's
common
law liabil-
ity.

¹ To constitute a passenger it is not necessary that a person should pay fare *eo nomine*, when he is riding on a train with consent of the company and some form of consideration moves to the company from him. *Railroad Co. v. Lockwood*, 17 Wall. 357; *Railway Co. v. Stevens*, 95 U. S. 655; *Commonwealth v. Vermont, etc. R. R. Co.*, 108 Mass. 7; *Yeomans v. Contra Costa Steam Nav. Co.*, 44 Cal. 71; *Kentucky Central R. R. Co. v. Thomas*, 79 Ky. 160; *Pennsylvania Co. v. Woodworth*, 26 O. St. 585.

² A carrier may by special agreement restrict his liability for goods carried. The consent of the shipper, however, is necessary; for he can compel the carrier to carry with all responsibilities. *New Jersey Steam Navigation Co. v. Merchants' Bank*, 6 How. 344, 378; *Hollister v. Nowlen*, 19 Wend. 234; *Cole v. Goodwin*, *ib.* 251; *Clark v. Faxton*, 21 Wend. 153; *Dorr v. New Jersey Steam Navigation Co.*, 11 N. Y. 485; *Western Transn. Co. v. Newhall*, 24 Ill. 466; *Merchants' Despatch Trans. Co. v. Theilbar*, 86 Ill. 71; *Michigan Central R. R. Co. v.*

Hale, 6 Mich. 243; *Kansas Pac. Ry. Co. v. Reynolds*, 17 Kan. 251; *York Co. v. Central R. R.*, 3 Wall. 107.

³ *Lamb v. Camden and Amboy R. R. Co.*, 46 N. Y. 271; *Steinweg v. Erie Railway*, 43 N. Y. 123; *Squire v. N. Y. Central R. R. Co.*, 98 Mass. 239; *Grace v. Adams*, 100 Mass. 505; *Hoadley v. Northern Trans. Co.*, 115 Mass. 304.

When a loss arises from a cause in respect of which the carrier has stipulated for freedom from liability, a person damaged may show that had it not been for the negligent or otherwise improper conduct of the carrier, that cause would not have operated. *Transportation Co. v. Downer*, 11 Wall. 129; see *Holladay v. Kennard*, 12 Wall. 254; *Railroad Co. v. Reeves*, 10 Wall. 176; *Propeller Niagara v. Cordes*, 21 How. 7; *Nelson v. Woodruff*, 1 Black. 156; *Little Rock, etc. R'y Co. v. Talbot*, 39 Ark. 523; compare *Stokes v. Saltonstall*, 13 Pet. 181; *Railroad Co. v. Pollard*, 22 Wall. 341.

⁴ *York Co. v. Central Railroad*, 3 Wall. 107. See *Camp v. Hartford, etc. Steamboat Co.*, 43 Conn. 333.

§ 352. But neither a carrier of passengers nor a carrier of goods can competently stipulate for immunity from liability for losses or injuries caused by negligence for which it is responsible. Such a stipulation is void as against public policy. On this point the leading case is *Railroad Company v. Lockwood*.¹ Its reasoning is unanswerable; and the importance of the matter warrants somewhat extended quotation from the opinion of the court, which was given by Justice Bradley.

Carrier cannot stipulate against liability for negligence.

“As the duties and responsibilities of public carriers were prescribed by public policy, it has been seriously doubted whether the courts did wisely in allowing that policy to be departed from without legislative interference, by which needed modifications could have been introduced into the law. But the great hardship on the carrier in certain special cases, where goods of great value or subject to extra risk were delivered to him without notice of their character, and where losses happened by sheer accident without any possibility of fraud or collusion on his part, such as collisions at sea, accidental fire, etc., led to a relaxation of the rule to the extent of authorizing certain exemptions from liability in such cases to be provided for, either by public notice brought home to the owners of the goods or by inserting exemptions from liability in the bill of lading, or other contract of carriage. A modification of the strict rule of responsibility, exempting the carrier from liability for accidental losses, where it can be safely done, enables the carrying interest to reduce its rates of compensation. . . .

“The question is, whether such modification of responsibility by notice or special contract may not be carried beyond legitimate bounds, and introduce evils against which it was the direct policy of the law to guard; whether, for example, a modification which gives license and immunity to negligence and carelessness on the part of the public carrier, or his servants, is not so evidently repugnant to that policy, as to be altogether null and void; or at least null and void under certain circumstances. . . .

“It is a favorite argument in the cases which favor the extension of the carrier's right to contract for exemption from

¹ 17 Wall. 357.

liability, that men must be permitted to make their own agreements, and that it is no concern of the public on what terms an individual chooses to have his goods carried. . . .

“Is it true that the public interest is not affected by the individual contracts of the kind referred to? Is not the whole business community affected by holding such contracts valid? If held valid, the advantageous position of the companies exercising the business of common carriers is such that it places it in their power to change the law of common carriers in effect, by introducing new rules of obligation.

“The carrier and his customer do not stand on a footing of equality.¹ The latter is only one individual of a million. He cannot afford to higggle or stand out and seek redress in the courts. His business will not admit such a course. He prefers rather to accept any bill of lading, or sign any paper the carrier presents; often, indeed, without knowing what the one or the other contains. In most cases he has no alternative but to do this or abandon his business. . . . If the customer had any real freedom of choice, if he had a reasonable and practicable alternative, and if the employment of the carrier was not a public one, charging him with the duty of accommodating the public in the line of his employment; then, if the customer chose to assume the risk of negligence, it could with more reason be said to be his private affair, and no concern of the public.

“But the condition of things is entirely different, and especially so under the modified arrangements which the carrying trade has assumed. The business is mostly concentrated in a few powerful corporations, whose position in the body politic enables them to control it. They do, in fact, control it, and impose such conditions upon travel and transportation as they see fit, which the people are compelled to accept. . . .

“The conclusions to which we have come are:—

“First. That a common carrier cannot lawfully stipulate for exemption from responsibility when such exemption is not just and reasonable in the eye of the law.

“Secondly. That it is not just and reasonable in the eye of the law, for a common carrier to stipulate for exemption

¹ See *Mobile and Montgomery R'y Co. v. Steiner*, 61 Ala. 559.

from responsibility for the negligence of himself or his servants.

"Thirdly. That these rules apply both to carriers of goods and to carriers of passengers for hire, and with special force to the latter.

"Fourthly. That a drover travelling on a pass, such as was given in this case, for the purpose of taking care of his stock on the train, is a passenger for hire.¹

"We purposely abstain from expressing any opinion as to what would have been the result of our judgment had we considered the plaintiff a free passenger instead of a passenger for hire."²

§ 353. With one or two exceptions, the reasoning in *Railroad Company v. Lockwood* has been followed in every state where decisions conformable to the principles therein stated had not previously been rendered. The authorities for the proposition that a common carrier cannot validly stipulate for exemption from liability for its negligence and that of its servants are given in the note.³

¹ *Railroad Co. v. Lockwood*, 17 Wall. 357, 384. This case, also, disapproves distinctions between degrees of negligence.

² See also *Railway Co. v. Stevens*, 95 U. S. 655; *Bank of Kentucky v. Adams Ex. Co.*, 93 U. S. 174; *Express Co. v. Kountze Bros.*, 8 Wall. 342. Compare *Philadelphia and Reading R. R. Co. v. Derby*, 14 How. 468; *Steamboat New World v. King*, 16 How. 469; *Nolton v. Western R. R. Co.*, 15 N. Y. 444. In *Jacobus v. St. P. and Chi. R'y Co.*, 20 Minn. 125, it was held that a railroad company could not exempt itself from liabilities caused by its negligence to a person travelling on a free pass.

³ Alabama: *South and North Ala. R. R. Co. v. Henlein*, 52 Ala. 606; *Southern Express Co. v. Crook*, 44 Ala. 468; *Mobile and Ohio R. R. Co. v. Hopkins*, 41 Ala. 486; *Steele v.*

Townsend, 37 Ala. 247. Arkansas: *Taylor & Co. v. Little Rock, etc. R. R. Co.*, 39 Ark. 148; *Little Rock, etc. R'y Co. v. Talbot*, ib. 523. Colorado: *Merchants' Despatch Trans. Co. v. Cornforth*, 3 Col. 280. Connecticut: *Welch v. Boston & Albany R. R. Co.*, 41 Conn. 333. See *Camp v. Hartford, etc. Steamboat Co.*, 43 Conn. 333. Delaware: See *Flinn v. Phila., W. and B. R. R. Co.*, 1 Houston, 472. Georgia: *Borrey v. Cooper*, 28 Ga. 543; *Purcell v. Southern Exp. Co.*, 34 Ga. 315; *Georgia R. R. Co. v. Gann*, 68 Ga. 350. Indiana: *Indianapolis, etc. R. R. Co. v. Allen*, 31 Ind. 394; *Ohio and Miss. R. Co. v. Selby*, 47 Ind. 471; *Michigan Southern, etc. R. R. Co. v. Heaton*, 37 Ind. 448; *Rosenfeld v. Peoria, etc. Ry. Co.*, 103 Ind. 121. (Earlier Indiana cases holding contrary doctrines overruled.) A carrier may, however,

§ 354. It is also held that when a railroad or an express company agrees to transport a package beyond its terminus, or over

limit his extreme common law liability; *Adams Express Co. v. Fendrick*, 38 Ind. 150; provided the limitation is reasonable; *Adams Express Co. v. Reagan*, 29 Ind. 21. See *Evansville, etc. R. R. Co. v. Young*, 28 Ind. 516. Iowa: *Rose v. Des Moines Valley R. R. Co.*, 39 Iowa, 246. Kansas: *St. Louis K. C. & N. R'y Co. v. Piper*, 13 Kan. 505. See *Kansas Pac. R. R. Co. v. Reynolds*, 8 Kan. 623, 641. Kentucky: *Orndorff v. Adams Express Co.*, 3 Bush, 194; *Louisville, etc. R. R. Co. v. Brownlee*, 14 Bush, 590. Maine: *Willis v. Grand Trunk R. Co.*, 62 Me. 488; *Sager v. Portsmouth, etc. R. R. Co.*, 31 Me. 228. Massachusetts: See *Commonwealth v. Vermont, etc. R. R. Co.*, 108 Mass. 7; *School District v. Boston, Hartford and E. R. R. Co.*, 102 Mass. 552. Minnesota: *Shriver v. Sioux City, etc. R. R. Co.*, 24 Minn. 506; *Christenson v. American Express Co.*, 15 Minn. 270; *Jacobus v. St. Paul, etc. R'y Co.*, 20 Minn. 125. Mississippi: *Mobile and Ohio R. R. Co. v. Weiner*, 49 Miss. 725; *Southern Express Co. v. Moon*, 39 Miss. 822. Missouri: *Clark v. St. Louis, etc. R'y Co.*, 64 Mo. 440; *Reed v. Same*, 60 Mo. 199; *Ketchum v. American Merch. Union Exp. Co.*, 52 Mo. 390; *Lupe v. Atlantic, etc. R. R. Co.*, 3 Mo. App. 77. Nebraska: *Atchison and Neb. R. R. Co. v. Washburn*, 5 Neb. 117. New Hampshire: See *Hall v. Cheney*, 36 N. H. 26. North Carolina: *Smith v. North Carolina R. R. Co.*, 64 N. C. 235. Ohio: *Welsh v. Pittsburgh, Ft. W. and C. R. R. Co.*, 10 Ohio St. 65; *Cleveland, Painsville, etc. R. R. Co. v.*

Curran, 19 Ohio St. 1; *Cincinnati, etc. R. R. Co. v. Pontius*, 19 Ohio St. 221; *Union Exp. Co. v. Graham*, 26 Ohio St. 595, 598. Pennsylvania: *American Express Co. v. Second Nat. Bk.*, 69 Pa. St. 394; *Camden and Amboy R. R. v. Baldauf*, 16 Pa. St. 67; *Pennsylvania R. R. Co. v. Henderson*, 51 Pa. St. 315. See *Lancaster Co. Nat. Bk. v. Smith*, 62 Pa. St. 47; *Delaware, etc. Tow Boat Co. v. Starrs*, 69 Pa. St. 36. South Carolina: *Swindler v. Hilliard*, 2 Rich. L. 286. Tennessee: *Dillard v. L. and N. R. Co.*, 2 Lea, 288. Vermont: *Mann v. Birchard*, 40 Vt. 326. See *Farmers and Mec. Bk. v. Champlain Trans'n Co.*, 23 Vt. 205. Virginia: *Virginia and Tenn. R. R. Co. v. Sayers*, 26 Gratt. 328. West Virginia: *Maslin v. Balt. and Ohio R. R. Co.*, 14 West Va. 180; *Brown v. Adams Express Co.*, 15 West Va. 812. Wisconsin: *Black v. Goodrich Trans'n Co.*, 55 Wis. 319. (Gross negligence or fraud.)

Out of accord with the better and generally accepted doctrine are the courts of New York, Illinois, Louisiana (*semble*), and, perhaps, New Jersey. New York: A carrier may exempt himself from liability for personal injuries occasioned by its negligence, to a person travelling gratuitously or on a drover's pass. *Poucher v. New York C. R. R. Co.*, 49 N. Y. 263; *Bissell v. N. Y. C. R. R. Co.*, 25 N. Y. 442; *Wells v. N. Y. C. R. R. Co.*, 24 N. Y. 181. See *Perkins v. N. Y. C. R. R. Co.*, *ib.* 196. Likewise, carriers of goods may exempt themselves from liability even for negligence. *Knell v. U. S. and Brazil Steamship Co.*, 1 J. & Sp. 423; *Lee*

roads belonging to others, it cannot exempt itself from liability for losses arising from the negligence of another carrier over whose road it has contracted to transport the goods.¹

v. Marsh, 43 Barb. 102; *Boswell v. Hudson River R. R. Co.*, 5 Bos. 699; *Prentice v. Decker*, 49 Barb. 21. But the New York courts have narrowed their decisions down to the smallest possible scope; and unless exemption from liability for *negligence* is expressly stipulated for, no general exemption, however sweeping, will be held to include losses arising from negligence. *Mynard v. Syracuse, etc. R. R. Co.*, 71 N. Y. 180; *Blair v. Erie R'y Co.*, 66 N. Y. 313; *Magnin v. Dinsmore*, 56 N. Y. 168; *Holsapple v. Rome, etc. R. R. Co.*, 86 N. Y. 275, 277; *Nicholas v. N. Y. Cent. and H. R. R. Co.*, 89 N. Y. 370. Compare *Goldey v. Pennsylvania R. R. Co.*, 30 Pa. St. 242; *Canfield v. Baltimore & Ohio R. R. Co.*, 93 N. Y. 532; *Powell v. Same*, 32 Pa. St. 414; *Pennsylvania R. R. Co. v. Butler*, 57 Pa. St. 335; *Empire Trans'n Co. v. Wamsutta Oil Co.*, 63 Pa. St. 14. And exemptions cover only losses arising from lack of ordinary care; not those arising from gross negligence or fraud. *Westcott v. Fargo*, 63 Barb. 349; *Heineman v. Grand Trunk R. Co.*, 31 How. Pr. 430.

In Illinois "the doctrine is settled that railroad companies may by contract exempt themselves from liability on account of the negligence of their servants, other than that which is gross or wilful." *Arnold v. Illinois Cent. R. R. Co.*, 83 Ill. 273, 280; *Illinois Cent. R. R. Co. v. Read*, 37 Ill. 484; *Same v. Morrison*, 19 Ill. 136; *Western Trans'n Co. v. Newhall*, 24 Ill.

466; *Illinois Cent. R. R. Co. v. Adams*, 42 Ill. 474; *Adams Exp. Co. v. Haynes*, ib. 89; compare, however, *Boscowitz v. Adams Exp. Co.*, 93 Ill. 523, 534; and *Adams Exp. Co. v. Stettaners*, 61 Ill. 184. (Illinois decisions seem hardly consistent on this point.) When a person rides on a non-transferable free pass issued to another, he commits a fraud that will relieve the railroad company from responsibility for injuries to him, except for such as arise from gross or reckless negligence. *Toledo, W. and W. R'y Co. v. Beggs*, 85 Ill. 80. New Jersey: A railroad company is not liable for the negligent killing of a person accepting a free pass with a stipulation against liability for negligence. *Kinney v. Central R. R. Co.*, 32 N. J. L. 407; *aff'd* 34 N. J. L. 513. But see *Ashmore v. Penn. Steam Tow Co.*, 28 N. J. L. 180, 192. Louisiana: A carrier may stipulate for exemption from liability for personal injuries to a news agent on the train, arising through the negligence of its servants; provided the servants are guilty of no fraudulent, wilful, or reckless misconduct. *Higgins v. New Orleans, etc. R. R. Co.*, 28 La. Ann. 133.

¹ *Bank of Kentucky v. Adams Exp. Co.*, 93 U. S. 174; *Cincinnati, etc. R. R. Co. v. Pontius*, 19 Ohio St. 221; *Galveston, etc. Ry. Co. v. Allison*, 59 Tex. 193. Contra, *Gibson v. American Merchants' Union Exp. Co.*, 1 Hun (N. Y.), 387. For liability of a carrier for losses occurring at connecting lines, see §§ 362-364.

§ 355. A carrier may establish reasonable regulations for the safety of baggage, and is not liable when a passenger, knowing of such regulations, loses his baggage through failure to comply with them.¹ Giving the opinion of the Federal Supreme Court, in *Railroad Co. v. Fraloff*,² Justice Harlan said: "It is undoubtedly competent for carriers of passengers by specific regulations, distinctly brought to the knowledge of the passenger, which are reasonable in their character, and not inconsistent with any statute or their duties to the public, to protect themselves against liability, as insurers, for baggage exceeding a fixed amount in value, except upon additional compensation proportioned to the risk. And, in order that such regulations may be practically effective, and the carrier advised of the full extent of its responsibility, and consequently of the degree of precaution necessary on its part, it may rightfully require, as a condition precedent for any contract for the transportation of baggage, information from the passenger as to its value; and if the value thus disclosed exceeds that which the passenger may reasonably demand to be transported as baggage without extra compensation, the carrier, at its option, can make such additional charge as the risk fairly justifies. And the carrier may be discharged from liability for the full value of the passenger's baggage, if the latter, by false statements, or by any device or artifice, puts off inquiry as to such value, whereby is imposed upon the carrier responsibility beyond that which it was bound to assume in consideration of the ordinary fare charged for the transportation of the person [so far *obiter*]. But in the absence of legislation limiting the responsibility of carriers for the baggage of passengers; in the absence of reasonable regulations upon the subject by the carrier, of which the passenger has knowledge; in the absence of inquiry of the passenger as to the value of articles carried, under the name of baggage, for his personal use and convenience in travelling; and in the absence of conduct upon the part of the passenger misleading the carrier as to the value of his baggage, the court cannot in law declare that the mere failure of the passen-

¹ *Gleason v. Goodrich Trans'n Co.*, 32 Wis. 85. ² 100 U. S. 24, 27

ger to disclose, unasked, the value of his baggage is a fraud upon the carrier, which defeats all rights of recovery."

There is in law no fixed limit to the value of baggage for which the carrier is responsible, when he does not limit his responsibility by special contract. But his responsibility as insurer is limited to such articles as it is customary or reasonable for travellers of the same class in life to which the passenger may belong to take for the journey in hand, and does not extend to those which the caprice of a particular passenger might lead him to take; and it rests with the jury to determine the special case in accordance with these principles.¹

§ 356. Just as carriers of passengers may place a limit on the value of baggage for which they will be liable, unless the value is disclosed and additional compensation paid, so carriers of goods may limit their liability in the same respect. And when the value of goods is agreed on, the railroad company is not liable above that amount even when the loss is caused by its negligence. "Where a contract of this kind, signed by the shipper, is fairly made, agreeing on the valuation of the property carried, with the rate of freight based on the condition that the carrier assumes liability

Limitations of carrier's liability in amount.

¹ Railroad Co. v. Fraloff, 100 U. S. 24, *supra*. In this case the carrier was held liable for laces stolen from the baggage of a Russian countess, and valued by the jury at ten thousand dollars. See also Del Valle v. Steamboat Richmond, 27 La Ann. 90.

A carrier is liable for money in baggage to an amount *bona fide* taken for travelling purposes, and not more than a prudent person would deem necessary and proper to take. Jordan v. Fall River R. R. Co., 5 Cush. 69; Merrill v. Grinnel, 30 N. Y. 594. See Dunlap v. International Steamboat Co., 98 Mass. 371; Orange County Bank v. Brown, 9 Wend. 85; Hawkins v. Hoffman, 6 Hill (N. Y.), 586; Doyle v. Kiser, 6 Ind. 242; Toledo, W. and W. R. R. Co. v. Hammond, 33 Ind.

379. A carrier is not liable as such for sixteen thousand dollars' worth of bonds violently taken from the person of a passenger. Weeks v. N. Y., N. H. and H. R. R. Co., 72 N. Y. 50; nor for thirty thousand dollars' worth of jewelry in baggage. Michigan Central R. R. Co. v. Carrow, 73 Ill. 348. Nor for a loss of merchandise carried as baggage. Stimson v. Connecticut River R. R. Co., 98 Mass. 83; Alling v. Boston and Albany R. R. Co., 126 Mass. 121; Pardee v. Drew, 25 Wend. 459. Unless having been advised of the merchandise, it charges and receives a sum in addition to the passenger's fare for the extra weight. Perley v. N. Y. C. and H. R. R. Co., 65 N. Y. 374.

only to the extent of the agreed valuation, even in cases of loss or damage by the negligence of the carrier, the contract will be upheld as a proper and lawful mode of securing a due proportion between the amount for which the carrier may be responsible and the freight he receives, and of protecting himself against extravagant and fanciful valuations."¹ When, however, there is no notice of such limitation, a person delivering goods to a carrier is not bound to state their value.² Restrictions as to the time within which a loss must be notified to the carrier in order to render him liable, are generally held reasonable and valid.³

§ 357. Although telegraph companies, according to the generally accepted view, are not common carriers,⁴ they exercise a function of great public importance;⁵ and the reasoning on which, in *Railroad Company v.*

Telegraph
companies.

¹ *Hart v. Pennsylvania R. R. Co.*, 112 U. S. 331, 343; op'n of court per Blatchford, J.; *Graves v. Lake Shore, etc. R. R. Co.*, 137 Mass. 33; *Harvey v. Terre Haute, etc. R. R. Co.*, 74 Mo. 538; *Magnin v. Dinsmore*, 70 N. Y. 410; S. C., 62 N. Y. 65. Contra, *Chicago, St. L. & N. O. R. R. Co. v. Abels*, 60 Miss. 1017.

² *Little v. Boston and Maine R. R.*, 66 Me. 239; *Phillips v. Earle*, 8 Pick. 182; see also *Chicago and Alton R. R. Co. v. Shea*, 66 Ill. 471; *Houston, etc. R. R. Co. v. Burke*, 55 Tex. 323. But the carrier may inquire as to value, and the shipper is bound by his answer. Same cases.

³ Within five days valid, *Black v. Wabash, etc. R'y Co.*, 111 Ill. 351; within ninety days valid, *Express Co. v. Caldwell*, 21 Wall. 264; within thirty days, *United States Express Co. v. Harris*, 51 Ind. 127; *Weir v. Express Co.*, 5 Phila. 355. Contra, *Southern Exp. Co. v. Caperton*, 44 Ala. 101. A stipulation in a bill of lading that damage must be adjusted before the articles are taken

from the station, and a claim presented within thirty days to "a trace-agent," is unreasonable and void. *Capehart v. Seaboard, etc. R. R. Co.*, 81 N. C. 438.

⁴ *Leonard v. N. Y., etc. Tel. Co.*, 41 N. Y. 544; *Brease v. U. S. Tel. Co.*, 48 N. Y. 132; *Schwartz v. Atlantic, etc. Tel. Co.*, 18 Hun, 157; *Pinckney v. Western Un. Tel. Co.*, 19 S. C. 71; *Ellis v. American Tel. Co.*, 13 Allen, 226; *Birney v. N. Y., etc. Tel. Co.*, 18 Md. 341; *Western Union Tel. Co. v. Fontaine*, 58 Ga. 433; *Same v. Carew*, 15 Mich. 525; *Western Union Tel. Co. v. Neill*, 57 Tex. 283. Contra, *Parks v. Tel. Co.*, 13 Cal. 422. Compare *Western Union Tel. Co. v. Meyer*, 61 Ala. 158.

⁵ The right of eminent domain may properly be granted to a telegraph company; property taken by such a company is taken for a public use. *Pierce v. Drew*, 136 Mass. 75. Compare *Central Union Telephone Co. v. Bradbury*, 106 Ind. 1; *Hockett v. State*, 105 Ind. 250.

Lockwood,¹ the court based the rule that common carriers cannot validly stipulate for immunity from responsibility for their negligence, applies to telegraph companies with equal force.² Accordingly, the better and more salutary view seems to be, that any stipulation inserted in a telegraph blank, restricting the liability of the company, unless the message is repeated, will not exempt it from responsibility for errors occasioned by the negligence of its employés.³ But many authorities oppose this view, holding that a telegraph company may thus exempt itself, except for such errors as arise from "gross negligence" or wilful misconduct on the part of its employés.⁴

¹ § 352.

² See *Telegraph Co. v. Griswold*, 37 Ohio St. 301, 313.

³ *Western Union Tel. Co. v. Blanchard*, 68 Ga. 299; *Telegraph Co. v. Griswold*, 37 Ohio St. 301; *Western Union Tel. Co. v. Fontaine*, 58 Ga. 433; *Sweatland v. Ill. and Miss. Tel. Co.*, 27 Iowa, 433; *Manville v. Western Union Co.*, 37 Iowa, 214; *Western Union Tel. Co. v. Graham*, 1 Col. 230; *Tyler v. Western Union Tel. Co.*, 60 Ill. 421; *S. C.*, 74 Ill. 168; *United States Tel. Co. v. Gildersleeve*, 29 Md. 232; *Western Union Tel. Co. v. Neill*, 57 Tex. 283. Even though it be a "night message," company liable for errors from negligence (nothing contained in blank as to repeating). *Bartlett v. Western Union Tel. Co.*, 62 Me. 209; *Hibbard v. Western Union Tel. Co.*, 33 Wis. 558; *Candee v. Same*, 34 Wis. 471. *Contra*, *Schwartz v. Atlantic, etc. Tel. Co.*, 18 Hun, 157. Nor can the company stipulate that the damages arising from mistakes in unrepeatd messages shall not exceed the price of the message. *Western Union Tel. Co. v. Blanchard*, 68 Ga. 299; *Thompson v. Western Union Tel. Co.*, 64 Wis. 531. A telegraph company can-

not avoid the penal liability imposed by statute for failure to transmit a message correctly, by a contract fixing its liability at a less sum. *Western Union Tel. Co. v. Adams*, 87 Ind. 598. See *Same v. Young*, 93 Ind. 118. Compare *Same v. Jones*, 95 Ind. 228; *Same v. Meredith*, ib. 93; *Same v. Pendleton*, ib. 12.

⁴ *Grinnell v. Western Union Tel. Co.*, 113 Mass. 299; *Breese v. U. S. Tel. Co.*, 48 N. Y. 132; *Becker v. Western Union Tel. Co.*, 11 Neb. 87; *Ellis v. Amer. Tel. Co.*, 13 Allen, 226; *Passmore v. Western Union Tel. Co.*, 78 Pa. St. 238; *Western Union Tel. Co. v. Carew*, 15 Mich. 525; *Camp v. Western Union Tel. Co.*, 1 Metc. (Ky.) 164; *Wann v. Western Union Tel. Co.*, 37 Mo. 472; *MacAndrew v. Electric Tel. Co.*, 17 C. B. 3. It may be said, however, that in these cases no negligence appeared beyond the fact that there was an error; and perhaps they are not to be regarded as express authorities for the statement that these stipulations cover negligence on the part of the telegraph company or its employés. A stipulation in a telegraph blank that the company will not be responsible for mistakes in unrepeatd messages is reason-

The failure to transmit and deliver the message as received, is *prima facie* negligence, rendering the company liable; and the burden of proof rests on it to clear itself from fault.¹

§ 358. At this point it will be well to consider what evidence will show an agreement, consent, or acquiescence on the part of a passenger or shipper to limitations on the liability of the carrier. As there is rarely an express assent in such cases, whether there was any assent at all becomes a question for the jury to guess

Evidence of assent to limitations of carrier's liability.

at under the guidance of the court, unless the circumstances are such as to estop the person dealing with the carrier from denying his assent. The cardinal distinction seems to lie here; the passenger or shipper will be presumed—though the presumption will not always be conclusive—to have agreed to whatever lawful terms are expressed on the face of a paper received by him from the agent of the carrier, when that paper contains the contract between the carrier and the person dealing with it. If, however, the paper so received does not express the contract of the parties, and is but a mere check, or ticket given by the carrier, there will arise no presumption that the person dealing with the carrier assented to its terms. The general idea is well expressed by Judge Boardman in *Kirkland v. Dinsmore*:² “When a person, from the nature of the business, the manner in which it is transacted, and all the circumstances surrounding it, knows or has reason to believe, he is receiving a contract that will bind him, he will be bound whether he reads or not. But where he may honestly, and in good faith, suppose he is

able; but would not cover *gross* negligence or wilful misconduct. *Lassiter v. Western Union Tel. Co.*, 89 N. C. 334; *Hart v. Western Union Tel. Co.*, 66 Cal. 579.

¹ *Telegraph Co. v. Griswold*, 37 Ohio St. 301; *Bartlett v. Western Un. Tel. Co.*, 62 Me. 209; *Rittenhouse v. Independent Line of Telegraph*, 44 N. Y. 263; *Baldwin v. U. S. Tel. Co.*, 45 N. Y. 744; *Western Un. Tel. Co. v. Carew*, 15 Mich. 525, 533; *Tyler v. Western Un. Tel. Co.*,

60 Ill. 421; *De La Grange v. South Western Tel. Co.*, 25 La. Ann. 383; *Western Un. Tel. Co. v. Meek*, 49 Ind. 53; *Turner v. Hawkeye Tel. Co.*, 41 Iowa, 458. Compare *Koons v. Western Union Tel. Co.*, 102 Pa. St. 164; *Western Union Tel. Co. v. Reynolds*, 77 Va. 173. Contra, *Aiken v. Western Union Tel. Co.*, 69 Iowa, 31.

² 2 Hun, 46, 51. See also *Blossom v. Dodd*, 43 N. Y. 264; *Madan v. Sherard*, 73 N. Y. 329.

receiving a check, token, receipt, or voucher of some kind, or ticket, as evidence of money paid, he will not be bound by a contract attached thereto, forming no necessary part thereof, to which his attention is not called, and which through ignorance, haste, or inadvertence, he neglects to read or assent to."

§ 359. In accordance with this rule, a shipper of goods will be presumed to have agreed to the terms of a bill of lading or "receipt" received by him; as this ordinarily contains the contract between the shipper and the carrier.¹ Indeed, it is held that the terms of a bill of lading cannot be contradicted by parol evidence.² But there are many authorities adverse to the two propositions last stated.³

¹ *Magnin v. Dinsmore*, 70 N. Y. 410; *S. C.*, 62 N. Y. 35; *Cincinnati, etc. R. R. Co. v. Pontius*, 19 Ohio St. 221; *Hill v. Syracuse, etc. R. R. Co.*, 73 N. Y. 351; *Grace v. Adams*, 100 Mass. 505; *Louisville, etc. R. R. Co. v. Brownlee*, 14 Bush (Ky.), 590; *Farnham v. Camden and Amboy R. R. Co.*, 55 Pa. St. 53; *Patterson v. Clyde*, 67 Pa. St. 500; *Fibel v. Livingston*, 64 Barb. 179; *Belger v. Dinsmore*, 51 N. Y. 166; *Newburger v. Howard & Co.'s Express*, 6 Phila. 174; *Steers v. Liverpool, etc. Steamship Co.*, 57 N. Y. 1; *Huntingdon v. Dinsmore*, 4 Hun, 66; *Prentice v. Decker*, 49 Barb. 21; *Knell v. U. S. and Brazil Steamship Co.*, 1 J. & Sp. (N. Y.) 423; *Lee v. Marsh*, 43 Barb. 102; *Boswell v. Hudson River R. R. Co.*, 5 Bos. (N. Y.) 699; *Muser v. Holland*, 17 Blatchf. 412; *Wertheimer v. Pennsylvania R. R. Co.*, ib. 421; *Robinson v. Merchants' Despatch Trans. Co.*, 45 Iowa, 470; *Louisville and N. R. R. Co. v. Brownville*, 14 Bush (Ky.), 590; *McMillan v. Michigan Southern, etc. R. R. Co.*, 16 Mich. 79. See *Pemberton Co. v. N. Y. C. R. R. Co.*, 104 Mass. 144; *Germania Fire Ins. Co. v. M. and C. R. R. Co.*,

72 N. Y. 90; compare *Woodruff v. Sherrard*, 9 Hun, 322. But a bill of lading delivered subsequently to the shipment may not have this effect. *Bostwick v. Baltimore, etc. R. R. Co.*, 45 N. Y. 712; *Gaines v. Union Trans. Co.*, 28 O. St. 418; *American Express Co. v. Spellman*, 90 Ill. 455. Compare *Wilde v. Merchants' Dispatch Trans. Co.*, 47 Iowa, 272.

² *Cincinnati, etc. R. R. Co. v. Pontius*, 19 Ohio St. 221; *Hill v. Syracuse, etc. R. R. Co.*, 73 N. Y. 351. Compare *Madan v. Sherard*, ib. 329. *Contra*, *Dillard v. L. and N. R. R. Co.*, 2 Lea (Tenn.), 288; *Erie and Western Trans. Co. v. Dater*, 91 Ill. 195.

³ *Southern Express Co. v. Armstead*, 50 Ala. 350; *Merchants' Despatch Trans. Co. v. Theilbar*, 86 Ill. 71; *Same v. Leysor*, 89 Ill. 43; *Field v. Chicago and R. I. R. Co.*, 71 Ill. 458; *Erie and N. Trans. Co. v. Dater*, 91 Ill. 195. See *Railroad Co. v. Manufacturing Co.*, 16 Wall. 319; *Verner v. Sweitzer*, 32 Pa. St. 208; *Erie and Western Trans. Co. v. Dater*, 91 Ill. 195; *Merchants' Despatch Transn. Co. v. Joesting*, 89 Ill. 152; *Dillard v. L. and N. R. R. Co.*, 2 Lea (Tenn.), 288.

There is no presumption that a shipper knows of or assents to mere published notices; and accordingly they will not be effectual in limiting the liability of the carrier;¹ except as to the amount beyond which he will not be liable when not informed of the value of the goods.² A notice printed on the back of a passenger ticket is not effectual to limit the value of the baggage for which the carrier will be liable; at least in the absence of proof that the passenger's attention was called to it; and reading such a notice after he has entered on his journey does not affect his rights.³

§ 360. The liability of a common carrier, as such, begins as soon as goods are delivered to it for transportation; nothing remaining to be done on the part of the shipper. Under such circumstances the carrier's liability is not that of a warehouseman while the goods are waiting in his depot before transportation.⁴ The carrier's liability, as such, continues until he has performed his duties as carrier; which in the case of railroad companies, are to carry the goods to the point on the road to which the goods are

When carrier's liability begins, and ceases.

¹ *New Jersey Steam Nav'n Co. v. Merchants' Bank*, 6 How. 344, 378; *Judson v. Western R. R. Co.*, 6 Allen, 486; *Hollister v. Nowlen*, 19 Wend. (N. Y.) 234; *Cole v. Goodwin*, ib. 251; *Dorr v. New Jersey Steam Nav. Co.*, 11 N. Y. 485; *Steele v. Townsend*, 37 Ala. 247; *Michigan Central R. R. Co. v. Hale*, 6 Mich. 243; *Pittsburgh, C. and St. L. Ry. Co. v. Barrett*, 36 O. St. 448. See *Perry v. Thompson*, 98 Mass. 249; *Baltimore and Ohio R. R. Co. v. Brady*, 32 Md. 333; *Camden and Amboy R. R. Co. v. Baldauf*, 16 Pa. St. 67.

² *Oppenheimer v. United States Exp. Co.*, 69 Ill. 62; *Erie Ry. Co. v. Wilcox*, 84 Ill. 239. Compare *Magnin v. Dinsmore*, 70 N. Y. 410; S. C., 62 N. Y. 35; S. C., 56 N. Y. 168; *Alabama, Gt. Southern R. R. Co. v. Little*, 71 Ala. 611; *United States Exp. Co. v. Backman*, 28 O. St. 144; *Bos-*

cowitz v. Adams Exp. Co., 93 Ill. 523; *Kansas City, St. Jo., etc. R. R. Co. v. Simpson*, 30 Kan. 645.

³ *Rawson v. Pennsylvania R. R. Co.*, 48 N. Y. 212; see *Limburger v. Westcott*, 49 Barb. 283; *Sunderland v. Westcott*, 40 How. Pr. (N. Y.) 468; *Brown v. Eastern R. R. Co.*, 11 Cush. 97; *Malone v. Boston, etc. R. R. Co.*, 12 Gray, 388. Compare *Camden and Amboy R. R. Co. v. Baldauf*, 16 Pa. St. 67.

⁴ *Grand Trunk M'fg, etc. Co. v. Ullman*, 89 Ill. 244; *Clarke v. Needles*, 25 Pa. St. 338; *O'Neill v. N. Y. C. & H. R. R. Co.*, 60 N. Y. 138; *Pittsburgh, C. & St. L. Ry. Co. v. Barrett*, 36 O. St. 448. See *Grosvenor v. N. Y. C. R. R. Co.*, 39 N. Y. 34; *Baron v. Eldredge*, 100 Mass. 455; *Judson v. Western R. R. Co.*, 4 Allen, 520; *St. Louis A. & T. H. R. R. Co. v. Montgomery*, 39 Ill. 335.

directed,¹ then to deliver them to the consignee if he is present, or notify him of their arrival if he is absent and his address is known; and if the consignee is not ready to accept the goods, to warehouse them in a proper warehouse. Thus, the liability of the railroad company becomes that of a warehouseman as soon as the consignee has had reasonable time and opportunity to remove the goods.² In Massachusetts the liability of a railroad company as a common carrier is held to cease as soon as the transportation is accomplished and the goods have been stored by the railroad company, although the consignee may have had no notice of their arrival, nor opportunity to remove them.³

¹ Railroad companies are not held to make a personal delivery. *South & North Ala. R. R. Co. v. Wood*, 66 Ala. 167; *Norway Plains Co. v. Boston & M. R. R. Co.*, 1 Gray (Mass.), 263. Otherwise as to express companies. *American Un. Exp. Co. v. Robinson*, 72 Pa. St. 274. In the absence of provision in the bill of lading, the usage and custom at the port of delivery will control the mode of delivery of goods carried by water. *Richmond v. Union Steamboat Co.*, 87 N. Y. 240.

² *Fenner v. Buffalo, etc. R. R. Co.*, 44 N. Y. 505; *Roth v. Buffalo, etc. R. R. Co.*, 34 N. Y. 548; *McKinney v. Jewett*, 90 N. Y. 267; *Hedges v. Hudson River R. R. Co.*, 49 N. Y. 223; *Sprague v. New York Central R. R. Co.*, 52 N. Y. 637; *Pelton v. Rensselaer, etc. R. R. Co.*, 54 N. Y. 214. Compare *Buckley v. Great Western Ry. Co.*, 18 Mich. 121; *L. L. & G. R. R. Co. v. Maris*, 16 Kan. 333; *Culbreth v. Phila. W. & B. R. R. Co.*, 3 Houston (Del.), 392; *Hirshfield v. Central Pac. R. R. Co.*, 56 Cal. 484; *Jeffersonville R. R. Co. v. Cleveland*, 2 Bush (Ky.), 468; *Louisville C. & L. R. R. Co. v. Mahan*, 8

Bush (Ky.), 184; *Graves v. Hartford, etc. Steamboat Co.*, 38 Conn. 143; *Alabama & Tennessee Rivers R. R. Co. v. Kidd*, 35 Ala. 209; *Mobile, etc. R. R. Co. v. Prewitt*, 46 Ala. 63; *South & North Ala. R. R. Co. v. Woods*, 66 Ala. 167; *Butler v. Railroad Co.*, 8 Lea (Tenn.), 32; *Blumenthal v. Brainerd*, 38 Vt. 402; *Derosia v. Winona, etc. R. R. Co.*, 18 Minn. 133; *Pinney v. First Division St. P., etc. R. R. Co.*, 19 Minn. 251.

³ *Norway Plains Co. v. Boston & M. R. R.*, 1 Gray (Mass.), 263; *Rice v. Boston & W. R. R. Co.*, 98 Mass. 212; *Thomas v. Boston & P. R. R. Co.*, 10 Met. (Mass.) 472; *Rice v. Hart*, 118 Mass. 201; compare *Stevens v. Boston & M. R. R.*, 1 Gray (Mass.), 277. In Illinois the rule is the same as in Massachusetts. *Chicago & N. W. Ry. Co. v. Bensley*, 69 Ill. 630; *Cahn v. Michigan Central R. R. Co.*, 71 Ill. 96; *Rothschild v. Michigan Central R. R. Co.*, 69 Ill. 164; *Illinois Central R. R. Co. v. Friend*, 64 Ill. 303; *Porter v. Chicago & R. I. R. R. Co.*, 20 Ill. 407. See also *Bansemmer v. Toledo, etc. R. R. Co.*, 25 Ind. 434; *Chicago & C. A. L. R. R. Co. v. McCool*, 26 Ind. 140; *Pittsburgh,*

Delivery of the goods to a person other than the consignee or owner is a conversion, for which as a general rule the carrier will be liable.¹ Where, however, the carrier is to deliver the goods to a succeeding carrier for further transportation, it remains liable as carrier until it has actually delivered them to the next carrier; and its liability does not become that of a warehouseman simply because the next carrier fails for an unreasonable time to take the goods after notice and request to do so.²

§ 361. The duty to deliver, and the duty to deliver in due time are distinct obligations. The time of delivery may be made a matter of express contract;³ but when this is not so, a carrier must deliver within a reasonable time, *i. e.* the time within which it can deliver, using all reasonable exertion, and taking all reasonable precaution to avoid delay.⁴ To excuse a carrier for unusual delay in trans-

Delay in
transporta-
tion.

C. & St. L. Ry. Co. v. Nash, 43 Ind. 423; Francis v. Dubuque, etc. R. R. Co., 25 Iowa, 60; Mohr v. C. & N. W. R. R. Co., 40 Iowa, 579; Southwestern R. R. Co. v. Felder, 46 Ga. 433.

¹ Forbes v. Boston and Lowell R. R. Co., 133 Mass. 154; Winslow v. Vermont, etc. R. R. Co., 42 Vt. 700; Viner v. N. Y., etc. Steamship Co., 50 N. Y. 23; Price v. Oswego, etc. R. R. Co., ib. 213; Scheu v. Erie R'y Co., 10 Hun, 498; Little Rock, etc. R'y Co. v. Glidewell, 39 Ark. 487; Balto. and Ohio R. R. Co. v. Pumphrey, 59 Md. 390. See Jellett v. St. Paul, etc. R'y Co., 30 Minn. 265. Carrier is liable for a delivery on a forged order. American Merchants' Un. Exp. Co. v. Milk, 73 Ill. 224; Southern Exp. Co. v. Van Meter, 17 Fla. 783. When the carrier knows the goods to be the property of shipper, it is liable to him for their value, when without his knowledge it delivers them at the place of shipment to a third person on the order

of the consignee. Southern Exp. Co. v. Dickson, 94 U. S. 549.

So a carrier instructed to deliver only C. O. D. is liable to the shipper for damages, if it violates the instruction. Tooker v. Gormer, 2 Hilt. (N. Y.) 71. See Rathbun v. Citizens' Steamboat Co., 76 N. Y. 376. Misdirection of goods may relieve carrier; see Southern Exp. Co. v. Kaufman, 12 Heisk. (Tenn.) 161.

² Railroad Co. v. Manufacturing Co., 16 Wall. 319; Goold v. Chapin, 20 N. Y. 259; Irish v. Milwaukee, etc. R'y Co., 19 Minn. 376; see Mills v. Michigan Cent. R. R. Co., 45 N. Y. 622; Pratt v. Railway Co., 95 U. S. 43; compare Louisville, etc. R. R. Co. v. Campbell, 7 Heisk. (Tenn.) 253; Van Lindley v. Richmond, etc. R. R., 88 N. C. 547.

³ See Place v. Union Exp. Co., 2 Hilt. (N. Y.) 19.

⁴ Philadelphia, W. and B. R. R. Co. v. Lehman, 56 Md. 209; Wibert v. New York and E. R. R. Co., 12 N.

porting goods, the cause of delay must be something which the law regards as, beyond the carrier's control.¹ A strike of its locomotive engineers is not such an excuse,² nor an increased charge by a connecting carrier.³ But a carrier is not responsible for delay occurring without its fault, when there is no express agreement to transport within a specified time.⁴ In the absence of special contract and notice to the carrier of special circumstances, the measure of damages for delay in the transportation of merchandise is the difference between its value at its destination at the time when it ought to have been delivered in the ordinary course of transportation, and its value there at the time when actually delivered.⁵ The ordinary measure of dam-

Y. 245; *Cobb v. Illinois Central R. R. Co.*, 38 Iowa, 601; *Rome R. R. Co. v. Sullivan*, 32 Ga. 400. Similar obligation exists towards passengers. *Weed v. Panama R. R. Co.*, 17 N. Y. 362. For measure of damages for failure to deliver, see *Balto. and Ohio R. R. Co. v. Pumphrey*, 59 Md. 390.

¹ See *Tierney v. N. Y. C. and H. R. R. Co.*, 76 N. Y. 305. But if a railroad company knows of any cause of delay on its lines beyond its control, in order to free itself from liability, it must inform the shipper and stipulate against liability from delay. *Illinois Central R. R. Co. v. Cobb*, 54 Ill. 128; *Same v. Same*, ib. 143; *Illinois Central R. R. Co. v. Ashmead*, 58 Ill. 487; *Cobb v. Ill. Central R. R. Co.*, 88 Ill. 394.

² *Blackstock v. N. Y. and Erie R. R. Co.*, 20 N. Y. 48; *Read v. St. Louis, etc. R. R. Co.*, 60 Mo. 199; compare *Pittsburgh, etc. R. R. Co. v. Hollowell*, 65 Ind. 188; *Pittsburgh, Ft. W. and C. R. R. Co. v. Hazen*, 84 Ill. 36.

For the liability of a telegraph company for delay in transmitting a message, see *Logan v. Western Un. Tel.*

Co., 84 Ill. 468; *Mackay v. Same*, 16 Nev. 222.

³ *Condict v. Grand Trunk R. Co.*, 54 N. Y. 500.

⁴ *Wibert v. N. Y. and Erie R. R. Co.*, 12 N. Y. 245; see *Pittsburgh, Ft. W. and C. R. R. Co. v. Hazen*, *supra*. For damages arising from a mere delay occasioned by a temporary excess of business, a carrier is not responsible; if he is not in fault regarding the equipment of his road and facilities for doing the ordinary business. *Galena and C. N. R. Co. v. Rae*, 18 Ill. 488; *Michigan Central R. R. Co. v. Burrows*, 33 Mich. 6; *Thayer v. Burchard*, 99 Mass. 508. But temporary excess of business is no excuse when a carrier has contracted to deliver within a specified time. *Deming v. Grand Trunk R. R. Co.*, 48 N. H. 455. In regard to the effect of time tables, see *Gordon v. Manchester, etc. R. R.*, 52 N. H. 596; *Le Blanche v. London, etc. Railway Co.*, 24 W. R. 808.

⁵ *Ward v. New York Central R. R. Co.*, 47 N. Y. 29; *Cutting v. Grand Trunk Ry. Co.*, 13 Allen (Mass.) 381; *Ingledeu v. Northern Railroad*, 7 Gray (Mass.) 86; *Galena and C. N.*

ages when goods are lost or injured is their value at the place of destination, deducting freight, if unpaid.¹

§ 362. *Prima facie* a railroad company or other carrier is responsible only for the negligence and misfeasance of its own servants, and consequently is liable only for losses or injuries occurring on its own road, or on a road which it leases or otherwise controls.² But it may contract to transport passengers or goods to a point beyond its terminus,³ and having made such a contract will be liable as carrier for the whole trip, whether the loss occur on its own or on a connecting line.⁴

§ 363. So far the authorities may be regarded as unanimous. But in regard to the evidence from which a jury may be allowed to infer a contract on the part of the carrier to transport beyond

R. R. Co. v. Rae, 18 Ill. 488; Sherman v. Hudson River R. R. Co., 64 N. Y. 254; see Devereux v. Buckley, 34 O. St. 16; Illinois Central R. R. Co. v. Cobb, 72 Ill. 148. Compare Priestley v. Northern Indiana, etc. R. R. Co., 26 Ill. 205. See as to perishable goods, Place v. Union Exp. Co., 2 Hilt (N. Y.), 19; American Exp. Co. v. Smith, 33 O. St. 511; Michigan Central R. R. Co. v. Burrows, 33 Mich. 6.

¹ Northern Trans. Co. v. McClary, 66 Ill. 233; Ringgold v. Haven, 1 Cal. 108; Taylor v. Collier, 26 Ga. 122; Michigan Southern, etc. R. R. Co. v. Caster, 13 Ind. 164; McGregor v. Kilgore, 6 Ohio, 359; Robinson v. Merchants' Dispatch Trans. Co., 45 Iowa, 470. Compare Winne v. Illinois Central R. R. Co., 31 Iowa, 583; Breed v. Mitchell, 48 Ga. 533.

² Compare Nashville, etc. R. R. Co. v. Carroll, 6 Heisk. (Tenn.) 347; Mallory v. Tioga R. R. Co., 39 Barb. 488; De Mott v. Laraway, 14 Wend. 225; Macon, etc. R. R. Co. v. Mayes,

49 Ga. 355; Illinois Central R. R. Co. v. Kanouse, 39 Ill. 272, and § 170.

³ This proposition is universally accepted in the United States. Railroad Co. v. Pratt, 22 Wall. 123; Wheeler v. San Francisco, etc. R. R. Co., 31 Cal. 46; Peet v. Chicago and N. W. Ry. Co., 19 Wis. 118; Kyle v. Laurens R. R. Co., 10 Rich. L. (S. C.) 382; Baltimore, etc. Steamboat Co. v. Brown, 54 Pa. St. 77; St. Louis and I. M. R. R. Co. v. Larned, 103 Ill. 293. Unless perhaps in Connecticut. See Hood v. N. Y. and N. H. R. R. Co., 22 Conn. 502.

⁴ Railway Co. v. McCarthy, 96 U. S. 258; Railroad Co. v. Androscoggin Mills, 22 Wall. 594. Cases in the following notes. Compare Wilson v. Harry, 32 Pa. St. 270. A railroad company is liable as a common carrier to another railroad company for a car of the latter, and the contents hauled by the former over its road. Peoria and P. N. Ry. Co. v. Chicago, etc. Ry. Co., 109 Ill. 135.

its terminus, there is a difference of judicial opinion.¹ In England and a few of the states, it is held that from the mere receipt of goods directed to a point beyond its own line, a contract to carry the whole distance may be inferred.² This is not, however, the prevailing doctrine in this country; where the rule generally followed is as stated by Justice Field delivering the opinion of the Supreme Court of the United States in *Myrick v. Michigan Central R. R. Co.*³

“A railroad company is a carrier of goods for the public, and, as such, is bound to carry safely whatever goods are intrusted to it for transportation, within the course of its business, to the end of its route, and there deposit them in a suitable place for their owners or consignees. If the road of the company connects with other roads, and goods are received for transportation beyond the termination of its own line, there is superadded to its duty as a common carrier that of a forwarder by the connecting line; that is, to deliver safely the goods to such line,—the next carrier on the route beyond. This forwarding duty arises from the obligation implied in taking the goods for the point beyond its own line. The common law imposes no greater duty than this. If more is expected from the company receiving the shipment, there must be a special agreement

¹ When a carrier receives express goods, the question whether he contracts to carry them to their destination, or only to deliver safely to the next carrier, is one of fact for the jury, dependent on the circumstances. *Phila. and Reading R. R. Co. v. Ramsey*, 89 Pa. St. 474. Compare *Penn. R. R. Co. v. Berry*, 68 Pa. St. 272.

² *Muschamp v. Lancaster Ry. Co.*, 8 M. & W. 421; *Webber v. Great Western Ry. Co.*, 3 H. & C. 771; *Wabash, St. L. & P. Ry. Co. v. Jaggerman*, 115 Ill. 407; *Mobile and Girard R. R. Co. v. Copeland*, 63 Ala. 219; *Louisville, etc. R. Co. v. Weaver*, 9 Lea (Tenn.), 38. See also *East Tenn. and Va. R. R. Co. v. Rogers*, 6 Heisk. (Tenn.) 143; *Wes-*

tern and Atlantic R. R. Co. v. McElwee, ib. 208; *Mosher v. Southern Exp. Co.*, 38 Ga. 37; *Southern Exp. Co. v. Shea*, 38 Ga. 519; *Cohen v. Southern Exp. Co.*, 45 Ga. 148. If goods are delivered to a carrier to be carried to a place beyond its terminus, and no receipt is taken, but freight is paid for the whole distance, the carrier will be liable for a loss occurring beyond its own line. *Adams Exp. Co. v. Wilson*, 81 Ill. 339. A carrier checking baggage beyond his line remains liable as insurer if he forwards baggage by a route other than that by which he has agreed. *Isaacson v. N. Y. C. & H. R. R. Co.*, 94 N. Y. 278.

³ 107 U. S. 102.

for it. This is the doctrine of this court, though a different rule of liability is adopted in England and in some of the states. . . . The general doctrine, then, as to transportation by connecting lines, approved by this court, and also by a majority of state courts, amounts to this: that each road confining itself to its common-law liability is only bound, in the absence of a special contract, to safely carry over its own route and safely to deliver to the next connecting carrier, but that any one of the companies may agree that over the whole route its liability shall extend. In the absence of a special agreement to that effect such liability will not attach, and the agreement will not be inferred from doubtful expressions or loose language, but only from clear and satisfactory evidence."¹ The same general doctrine is also clearly stated by Judge Rapallo, of the New York Court of Appeals, in *Root v. Great Western R. R. Co.*² "The receipt of goods marked for a place beyond the terminus of the carrier's route does not import a contract to carry them to their final destination; but, in the absence of a special contract, and of a partnership between the connecting lines, the carrier is only responsible to the extent of his own route, and for the safe delivery to the next succeeding carrier; in such a case the carrier is merely a forwarder from the terminus of his own line, and where goods thus marked are delivered to a carrier, unaccompanied by any particular directions, except such as might be inferred from the marks themselves, the carrier is only bound at the terminus of his own line, to deliver them according to the established usage of the business in which he is engaged."³ On the other hand, from the bill of lading taken

¹ *Myrick v. Michigan Central R. R. Co.*, 107 U. S. 102, 106.

² 45 N. Y. 524, 530.

³ *Accord Van Santvoord v. St. John*, 6 Hill, 158; *Railroad Co. v. Pratt*, 22 Wall. 123; *Jenneson v. Railroad Co.*, 4 Am. Law. Reg. 234 and note; *Rome R. R. Co. v. Sullivan*, 25 Ga. 228; *Piedmont M'fg Co. v. Columbia*, etc. R. R. Co., 19 S. C. 358; *Brintnall v. Saratoga*, etc. R. R. Co., 32 Vt. 665; *Lawrence v. Winona*,

etc. R. R. Co., 15 Minn. 390; *Irish v. Milwaukee*, etc. R. R. Co., 19 Minn. 376. See *Mullarkey v. P. W. and B.*

R. R. Co., 9 Phila. 114 (with which last case compare *St. Louis and I. M. R. R. Co. v. Larned*, 103 Ill. 293); *Skinner v. Hall*, 60 Me. 477; *Hadd v. U. S. and Can. Exp. Co.*, 52 Vt. 335; *Clyde v. Hubbard*, 88 Pa. St. 358; *Penn. R. R. Co. v. Schwarzenberger*, 45 Pa. St. 208; *Burroughs v. Norwich*, etc. R. R. Co., 100 Mass. 26;

in connection with the circumstances of the case, a court may allow a jury to find a contract for through transportation, which will render liable the carrier who received the goods, no matter where the loss occurs.¹

§ 364. Where several carriers owning connecting lines make general agreements, under which they act in concert and as each other's agents in receiving and forwarding freight and passengers, any one of them over whose route have been transported the goods which are lost or damaged, may be held liable; or they may all be sued jointly.²

Mitting v. Conn. River R. R. Co., 1 Gray, 502; Montgomery, etc. R. R. Co. v. Moore, 51 Ala. 394; Crawford v. Southern R. R. Ass'n, 51 Miss. 222; Gray v. Jackson, 51 N. H. 9; Darling v. Boston and Worcester R. R. Co., 11 Allen, 295; Washburn, etc. M'fg Co. v. Providence, etc. R. R. Co., 113 Mass. 490. Compare Newell v. Smith, 49 Vt. 255; Goodrich v. Thompson, 44 N. Y. 324.

¹ See Railroad Co. v. Pratt, 22 Wall. 123; Clyde v. Hubbard, 88 Pa. St. 358; Peet v. Chicago and N. W. Ry. Co., 19 Wis. 118; Kyle v. Laurens R. R. Co., 10 Rich. L. (S. C.) 382. Compare Insurance Co. v. Railroad Co., 104 U. S. 146; Philadelphia and R. R. Co. v. Ramsey, 89 Pa. St. 474; Washburn M'fg Co. v. Providence, etc. R. R. Co., 113 Mass. 490; Hill M'fg Co. v. Boston and L. R. R. Co., 104 Mass. 122; Cincinnati H. and D. R. R. Co. v. Pontius, 19 O. St. 221; Clyde v. Hubbard, 88 Pa. St. 358; Baltimore and P. Steamboat Co. v. Brown, 54 Pa. St. 77; Pennsylvania R. R. Co. v. Berry, 68 Pa. St. 272. But compare Converse v. Norwich, etc. Trans. Co., 33 Conn. 166; Elmore v. Naugatuck R. R. Co., 23 Conn. 457; Lawrence v. New York, etc. R. R. Co., 36 Conn. 63. The

way-bill also is admissible as evidence of a through contract. Railroad Co. v. Androscoggin Mills, 22 Wall. 594. The doctrine of a number of cases is that the acceptance of goods for carriage marked for a point beyond the terminus of the carrier's line, is *prima facie* evidence of a contract for through transportation; but the carrier may limit its responsibility to its own line, *e. g.*, by a clause in the receipt given for the goods, although not signed by the shipper. Erie Ry. Co. v. Wilcox, 84 Ill. 239; Illinois Central R. R. Co. v. Frankenberg, 54 Ill. 88; Illinois Central R. R. Co. v. Johnson, 34 Ill. 389; Field v. Chicago and R. I. R. R. Co., 71 Ill. 458; Adams Exp. Co. v. Wilson, 81 Ill. 339; Mulligan v. Illinois Central Ry. Co., 36 Iowa, 181; Angle v. Mississippi, etc. R. R. Co., 9 Iowa, 487. Compare Merchants' Despatch Trans. Co. v. Moore, 88 Ill. 136; Berg v. Atchison, etc. R. R. Co., 30 Kan. 561.

² Barter v. Wheeler, 49 N. H. 9; Wyman v. Chicago and Alton R. R. Co., 4 Mo. App. 35; Hart v. Rensselaer, etc. R. R. Co., 8 N. Y. 37; Monell v. Northern Central R. R. Co., 67 Barb. 531. See Quimby v. Vanderbilt, 17 N. Y. 306; Nashua Lock Co. v. Worcester, etc. R. R. Co., 48

§ 365. A railroad or other corporation owes special duties to its employes; and if these duties are not fulfilled, and injury occurs to an employé in consequence, the corporation will ordinarily be liable in damages. To render a corporation liable to one of its servants for a personal injury sustained by the latter, the injury must have resulted from a breach of one of the following duties which the corporation owes its servants: first, to use reasonable care in selecting co-servants and to employ a reasonably sufficient number of them to make the employment safe;¹ secondly, to use reasonable diligence and care in supplying the servants with

Corporation's liability for injuries to employes.

N. H. 339 (contains review of authorities by Judge Perley); Cincinnati, H. and D. R. R. Co. v. Spratt, 2 Duv. (Ky.) 4. Compare Insurance Co. v. Railroad Co., 104 U. S. 146; Milnor v. N. Y. and N. H. R. R. Co., 53 N. Y. 363; Ricketts v. Balt. and O. R. R. Co., 59 N. Y. 637; Schiff v. N. Y. C. and H. R. R. Co., 16 Hun, 278; Darling v. Boston and Worcester R. R. Co., 11 Allen, 295; Railroad Co. v. Brumley, 5 Lea (Tenn.), 401; Gass v. New York, etc. R. R. Co., 99 Mass. 220; Ellsworth v. Tartt, 26 Ala. 733; Coates v. United States Exp. Co., 45 Mo. 238; Hot Springs R. R. v. Trippe, 42 Ark. 465. Where the combination extends through several states, the law of the state where the loss occurred is applicable. Barter v. Wheeler, 49 N. H. 9. Compare Hale v. N. J. Steam Nav. Co., 15 Conn. 539. The law of the state where the contract for carriage beyond the state is made must control as to the nature, interpretation, and effect of the contract. Michigan Central R. Co. v. Boyd, 91 Ill. 268; McDaniel v. Chicago and N. W. R'y Co., 24 Iowa, 412. But see Curtis v. Delaware, etc. R. R. Co., 74 N. Y. 116. It is only where the contract is for

through transportation that the succeeding carriers will be entitled to the benefits and exemptions of the contract between the shipper and the first carrier. Merchants' Despatch Trans'n Co. v. Bolles, 80 Ill. 473; Camden and Amboy R. R. Co. v. Forsyth, 61 Pa. St. 81. See Halliday v. St. Louis, etc. R'y Co., 74 Mo. 159; Manhattan Oil Co. v. Camden and Amboy R. R. Co., 54 N. Y. 197; Whitworth v. Erie Ry. Co., 87 N. Y. 413; Ætna Ins. Co. v. Wheeler, 5 Lans. (N. Y.) 480; Maghee v. Camden, etc. R. R. Co., 45 N. Y. 514; Railroad Co. v. Androscoggin Mills, 22 Wall. 594. Compare Taylor v. Little Rock, etc. R. R. Co., 39 Ark. 148.

¹ Wabash Ry. Co. v. McDaniels, 107 U. S. 454; Laning v. N. Y. Cent. R. R. Co., 49 N. Y. 521; Chicago and Alton R. R. Co. v. Sullivan, 63 Ill. 293; Harper v. Indianapolis, etc. R. R. Co., 47 Mo. 567; Besel v. N. Y. C. and H. R. R. Co., 70 N. Y. 171, 173; Booth v. Boston and Albany R. R. Co., 73 N. Y. 38; Huntington, etc. R. R. Co. v. Decker, 82 Pa. St. 119; see Atchinson, etc. R. R. Co. v. Moore, 29 Kans. 632; Kansas Pac. Ry. Co. v. Peavey, ib. 169.

safe machinery;¹ thirdly, to apprise the servants of latent dangers connected with their employment, or concealed defects in the machinery used by them, when the corporation knows or is affected with notice of such dangers or defects;² fourthly, to protect the servant against the negligence or incompetence of those who as to the servants represent the corporation; *i. e.*, superior agents who have authority over them;³ and, fifthly, to protect the servant from the negligent acts of other persons employed by the corporation in an employment different and distinct from that of the injured servant.⁴

¹ *Hough v. Railway Co.*, 100 U. S. 213; *Koegan v. Western R. R. Co.*, 8 N. Y. 175; *Vosburgh v. Lake Shore and M. S. R. Co.*, 94 N. Y. 374; *Mullan v. Philadelphia, etc. S. S. Co.*, 78 Pa. St. 25; *Noyes v. Smith*, 28 Vt. 59. Compare *Louisville and Nashville R. R. Co. v. Orr*, 84 Ind. 50; *Wonder v. Balto. and Ohio R. R. Co.*, 32 Md. 411; *Mobile and Ohio R. R. v. Thomas*, 42 Ala. 673; *Chicago and N. W. R. R. Co. v. Ward*, 61 Ill. 130; *Atchison, etc. R. R. Co. v. Holt*, 29 Kans. 149; *Fay v. Minneapolis, etc. R'y Co.*, 30 Minn. 231; *Lasure v. Graniteville M'fg Co.*, 18 S. C. 275. See *International, etc. R. R. Co. v. Kindred*, 57 Tex. 491; *Missouri Pac. R. R. Co. v. Lyde*, *ib.* 505; *Vosburgh v. Lake Shore and Mich. So. R. Co.*, 94 N. Y. 374. Although a railroad company employ competent men to inspect its machinery, it will be liable for their negligent performance of their duty. *Kirkpatrick v. N. Y. C. and H. R. R. Co.*, 79 N. Y. 240; *Ford v. Fitchburg R. R. Co.*, 110 Mass. 240; *Drymala v. Thompson*, 26 Minn. 40. Compare *Murphy v. Boston and A. R. R. Co.*, 88 N. Y. 146.

² *Keegan v. Western R. R. Co.*, 8 N. Y. 175; *Williams v. Clough*, 3 H.

& N. 258; *Paulmier v. Erie R. R. Co.*, 34 N. J. L. 151; *Malone v. Hawley*, 46 Cal. 409; *Ryan v. Fowler*, 24 N. Y. 410. See *Baxter v. Roberts*, 44 Cal. 187. Compare *Wonder v. Balto. and Ohio R. R. Co.*, 32 Md. 411.

³ *Hough v. Railway Co.*, 100 U. S. 213; *Little Miami R. R. Co. v. Stevens*, 20 Ohio, 415; see *Booth v. Boston and Albany R. R. Co.*, 73 N. Y. 38; *Besel v. N. Y. C. and H. R. R. R. Co.*, 70 N. Y. 171, 173; compare *Brabbitts v. Chicago and N. W. R'y Co.*, 38 Wis. 289; *Bunnell v. St. Paul, etc. R'y Co.*, 29 Minn. 305.

⁴ *Nashville and Chattanooga R. R. Co. v. Carroll*, 6 Heisk. (Tenn.) 347; *Chicago, B. and Q. R. R. Co. v. Gregory*, 58 Ill. 272; *Ryan v. Chicago and N. W. R'y Co.*, 60 Ill. 171; *Toledo, W. and W. R'y Co. v. Moore*, 77 Ill. 217; *Lewis v. St. Louis, etc. R. Co.*, 59 Mo. 495; *Baird v. Pettit*, 70 Pa. St. 477; *Cooper v. Mullins*, 30 Ga. 146. See *Atchison, etc. R. R. Co. v. Moore*, 29 Kans. 632; *Chicago and N. W. R'y Co. v. Moranda*, 93 Ill. 302; *Dobbin v. Richmond, etc. R. R. Co.*, 81 N. C. 446. Compare *Tunney v. Midland R'y Co.*, L. R. 1 C. P. 291.

In *Flike v. Boston and Albany R. R. Co.*, giving the opinion of the New York Court of Appeals, Chief Judge Church said: "The true rule, I apprehend, is to hold the corporation liable for negligence or want of proper care in respect to such acts and duties as it is required to perform and discharge as master or principal, without regard to the rank or title of the agent intrusted with their performance. As to such acts the agent occupies the place of the corporation, and the latter should be deemed present and consequently liable for the manner in which they are performed."¹ And these acts and duties which the corporation as master is bound to perform for the safety and protection of employes cannot be delegated so as to exonerate it from liability to the employes for omissions in the discharge thereof.² This seems the true principle, though many authorities do not hold to it.³

§ 366. The corporation will not be liable unless the servant's injury arises from a breach of one of these obligations.⁴ All other risks connected with his employment, as between himself and the corporation, the servant is held to assume; as, for instance, the negligence of co-servants who have been properly selected, and the ordinary risks connected with the use of dangerous machinery.⁵ If, however, negligence imputable to the

¹ 53 N. Y. 549, 553.

² *Fuller v. Jewett*, 80 N. Y. 46; *Northern Pac. R. R. Co. v. Herbert*, 116 U. S. 642.

³ Some decisions hold that when one employe is placed under the direction of another, the two are not co-employes, and the corporation is liable to the inferior employe for injuries resulting from the negligence of the superior employe. Thus, a railroad company has been held liable to an engineer or a brakeman for injuries caused by the negligence of the conductor of the same train. *Chicago and M. R. R. Co. v. Ross*, 112 U. S. 377 (Justices Bradley, Matthews, Gray, and Blatchford dissenting); *Cleveland C. and C. R. R. Co. v. Keavy*, 3 O. St.

201; *Little Miami R. R. Co. v. Stevens*, 20 Ohio, 415; see *Pittsburgh, Ft. W. and C. Ry. Co. v. Lewis*, 33 O. St. 196. Contra, *Lawler v. Androscoggin R. R. Co.*, 62 Me. 463; *O'Connell v. Baltimore and O. R. R. Co.*, 20 Md. 212; *Shanck v. Northern Central Ry. Co.*, 25 Md. 462.

⁴ *Henry v. Lake Shore, etc. Ry. Co.*, 49 Mich. 495. Compare *Kansas Pac. Ry. Co. v. Peavy*, 29 Kans. 169.

⁵ *Gibson v. Erie Ry. Co.*, 63 N. Y. 449; *Coon v. Syracuse, etc. R. R. Co.*, 5 N. Y. 492; *Randall v. Baltimore and O. R. R. Co.*, 109 U. S. 478; *Morse v. Minneapolis, etc. Ry. Co.*, 30 Minn. 465; *Wood v. New Bedford Coal Co.*, 121 Mass. 252; *Kelley v. Norcross*, ib. 508; *Ryan v. Cumber-*

corporation is the cause of the servant's injury, the carelessness of a co-servant in the same matter will be no defence.¹

§ 367. Hitherto we have been considering the liability of corporations for negligence or misfeasance of their employes, which causes the breach of some special duty owing by the corporation. To render a corporation liable for the negligence of its employes, however, it is not essential that the duty, a breach of which is caused by the negligence, should be a special duty arising from a contract. Enough, if it be the general duty owed by a corporation to all the world: *sic utere tuo ut alienum non lædas*. A corporation will be liable for all injuries and losses occasioned to any one by the negligence of its employes in any matter connected with their employment.²

Liability of corporation where it owes no special duty.

§ 368. For instance, it is the duty of a railroad corporation, for a breach of which it will be responsible, to warn persons on a highway crossing its road, by proper and timely signals, of the approach of trains.³ And if a flagman has been uniformly stationed by the company at a street crossing, his neglect to give warnings will be imputable to the company.⁴ Likewise, a railroad company is bound to

Railroad companies.

land Valley R. R. Co., 23 Pa. St. 384; Holden v. Fitchburg R. R. Co., 129 Mass. 268; Farwell v. Boston and N. R. R. Co., 4 Met. (Mass.) 49; Howland v. Milwaukee, etc. Ry. Co., 54 Wis. 226; Osbourne v. Knox, etc. R. R. Co., 68 Me. 49; Blake v. Maine Central R. R. Co., 70 Me. 60; Pittsburgh, Ft. W. and C. Ry. Co. v. Deviney, 17 O. St. 197. See Hough v. Railway Co., 100 U. S. 213; Patterson v. Wallace, 1 Macq. 748. Also Wharton on Negligence, 2d ed., §§ 224 *et seq.*, and the numerous authorities there cited.

¹ Grand Trunk Railway Co. v. Cummings, 106 U. S. 700; Keegan v. Western R. R. Co., 8 N. Y. 175; Booth v. Boston and Albany R. R. Co., 73 N. Y. 38; Stetler v. Chicago,

etc. Ry. Co., 46 Wis. 497; S. C. 49 Wis. 609.

² See Denver S. P. and P. R. R. Co. v. Conway, 8 Col. 1.

³ Dyer v. Erie Ry. Co., 71 N. Y. 228. It is not enough to absolve the company in all cases that the signals required by statute have been given; other precautions may be necessary under the circumstances. *Ib.* Compare Chicago, B. and Q. R. R. Co. v. Stumps, 69 Ill. 409; Continental Improvement Co. v. Stead, 95 U. S. 161; Railroad Co. v. Houston, *ib.* 697. But a failure to give the warning required by statute constitutes negligence. Central R. R., etc. Co. v. Litcher, 69 Ala. 106.

⁴ Doland v. Del. and Hud. Canal Co., 71 N. Y. 285.

use the most approved methods to prevent the escape of sparks from its locomotives;¹ and the fact that sparks escaped and set fire to property, has been held *prima facie* evidence of its negligence.² But the weight of authority, when no statute affects the case, places the burden on the plaintiff to show negligence on the part of the railroad company.³

§ 369. In the absence of statute, a railroad company is not bound to fence its road to keep off cattle; still, if cattle get on the track and the company's servants negligently run them down, the company will be liable, provided the accident could have been avoided by using due care.⁴ Common carriers are

¹ Wiley v. West Jersey R. R. Co., 44 N. J. L. 247; St. Louis, A. & T. H. R. R. Co. v. Gilham, 39 Ill. 455; Illinois Central R. R. Co. v. McClelland, 42 Ill. 355; Pittsburgh, C. & St. L. R. R. Co. v. Nelson, 51 Ind. 150. See Hoff v. West Jersey R. R. Co., 45 N. J. L. 400.

² Simpson v. Railroad Co., 5 Lea (Tenn.), 456; International and G. N. Ry. Co. v. Townsend, 61 Tex. 660; Burke v. Louisville and N. R. R. Co., 7 Heisk. (Tenn.) 451; Coates v. Missouri, K. and T. Ry. Co., 61 Mo. 38. See Spaulding v. Chicago and N. W. Ry. Co., 30 Wis. 110. But if it appears that the railroad company was not negligent, it will not be liable. Burroughs v. Housatonic R. R. Co., 15 Conn. 124; Hinds v. Barton, 25 N. Y. 544; Frankford, etc. Turnpike Co. v. Phila., etc. R. R. Co., 54 Pa. St. 345; Vaughan v. Taff Vale Ry. Co., 5 H. & N. 679.

³ Albert v. Northern Central Ry. Co., 98 Pa. St. 316; Railroad Co. v. Yeiser, 8 Pa. St. 366; Huyett v. Phila., etc. R. R. Co., 23 Pa. St. 373; Phila. and Reading R. R. Co. v. Yerger, 73 Pa. St. 121; Gandy v. Chicago and N. W. R'y. Co., 30 Iowa, 420; McCumans v. Same, 33

Iowa, 187; Burroughs v. Housatonic R. R. Co., 15 Conn. 124; Morris and Essex R. R. Co. v. State, 36 N. J. L. 553; Indianapolis and Cin. R. R. Co. v. Passmore, 31 Ind. 143; Smith v. Hannibal, etc., R. R. Co., 37 Mo. 287; McCreedy v. Railroad Co., 2 Strob. L. (S. C.) 356; Firo v. Buffalo, etc. R. R. Co., 22 N. Y. 209; Ruffner v. Cincinnati, etc., R. R. Co., 34 O. St. 96; Jefferies v. Philadelphia, etc. R. R. Co., 3 Houston (Del.), 447. See Kans. Pac. R. R. Co. v. Butts, 7 Kans. 308. But see Fitch v. Pacific R. R. Co., 45 Mo. 322; Bedford v. Hannibal and St. Jo. R. R. Co., 46 Mo. 456; Palmer v. Missouri Pac. Ry. Co., 76 Mo. 217. But this burden may readily be shifted by circumstances showing that, without negligence, the accident would not have happened. Field v. N. Y. C. R. R. Co., 32 N. Y. 339; Garrett v. Chicago and N. W. R'y. Co., 36 Iowa, 121. Compare Lindsay v. Winona, etc. R. R. Co., 29 Minn. 411; Woodson v. Milwaukee, etc. R. R. Co., 21 Minn. 60.

⁴ Railroad Co. v. Skinner, 19 Pa. St. 298; Continental Improvement Co. v. Phelps, 47 Mich. 299; Perkins v. Eastern R. R. Co., 29 Me. 307; Price v. New Jersey R. R. Co., 31 N.

not chargeable, in cases free from suspicion with notice of the contents of packages carried by them, nor are they authorized in such cases to require information as to the contents. Under such circumstances it is not negligence for a carrier to handle a package in the usual way, and when it appears damaged to bring it into his place of business for examination; accordingly, if a package containing a dangerous substance, of which the carrier has no knowledge, explodes, injuring premises leased by him, he will not be liable for the damage to his lessor.¹ The measure of care which should be observed by a carrier against accident to premises leased by him, is the care which a person of ordinary prudence and caution would use in his affairs.²

§ 370. The responsibility of a corporation for injuries caused by the acts or omissions of its servants may be lessened by the fact that the injured person was a trespasser at the time when the injury occurred; or by the fact that he contributed to his injury by his own negligence. These two facts often conjoin.

Liability
when lessened.

§ 371. Except at public crossings, where the public has a right of way, a railroad company has the exclusive right to its track, trestle-works, and bridges; and accordingly (it has been held) any person walking on the track is a trespasser, who cannot hold the company liable for injuries received by him, unless he shows it to have been

Trespassers.

J. L. 229; *Knight v. New Orleans*, etc. R. R. Co., 15 La. Ann. 105; this duty are generally liable for cattle killed on their tracks.

Gilman, etc. R. R. Co. v. Spencer, 76 Ill. 192; see *Illinois Cent. R. R. Co. v. Phelps*, 29 Ill. 447; *Galpin v. Chicago and N. W. R'y Co.*, 19 Wis. 604; *Brown v. Hannibal, etc. R. R. Co.*, 33 Mo. 309. Compare *North Penn. R. R. Co. v. Rehman*, 49 Pa. St. 101; *Munger v. Tonawanda R. R. Co.*, 4 N. Y. 349. Throughout the States of the Union railroad companies are now required to fence their roads by statutes, and if they fail in

¹ *Nitro-Glycerine Case*, 15 Wall. 524. Compare *Boston and Albany R. R. Co. v. Shanly*, 107 Mass. 568. The defendants, at their own expense, repaired the portions of the premises occupied by them; as they were bound to do under the terms of their lease; and it was for damage done by the explosion to other portions of the same premises that the court absolved them from liability.

² *Nitro-Glycerine Case*, *supra*.

guilty of negligence so gross as to amount to wantonness.¹ A late Pennsylvania decision, *Baltimore and Ohio R. R. Co. v. Schwindling*,² has carried to an extreme the doctrine that a corporation is not liable for the negligence of its employés which causes injury to trespassers. The court held that the company owed no duty to the plaintiff, a child of five years, who was upon the platform of a railroad station when injured, but not as a passenger, nor upon any business connected with the company; and accordingly that the company was not liable for injuries incurred by him through negligence imputable to it. The court may have overlooked a principle which seems not inapplicable to this case, and which might have altered the decision had it been applied. It is this: If a railroad company acquiesces in the custom of the public in using or crossing its stations or track at certain places, it will be held by its acquiescence or quasi-invitation to have held the premises out as reasonably safe; and will accordingly be liable to a person for injuries caused by their unsafe condition, if he himself was guilty of no contributory negligence.³ A railroad company has a right to exclude the general public from its stations,⁴ except such persons as offer themselves as passengers or shippers; but if it acquiesces—as appears to have been the case in *Baltimore and Ohio R. R. Co. v. Schwindling*—in the use of its stations by the general public, it should keep them safe.⁵

§ 372. Undoubtedly, as we have seen, there is authority for the proposition that a railroad company owes no duty to tres-

¹ *Mason v. Missouri Pac. R'y Co.*, 27 Kans. 83. See *Cauley v. Pittsburgh, C. and St. L. R'y Co.*, 95 Pa. St. 398; *Omaha, etc. R. R. Co. v. Martin*, 14 Neb. 295.

² 101 Pa. St. 258.

³ *Bennett v. Railroad Co.*, 102 U. S. 577; *Barry v. New York Cent. and H. R. R. Co.*, 92 N. Y. 289. See *Brown v. Hannibal, etc. R. R. Co.*, 50 Mo. 461; *Murphy v. C. R. I. and P. R. R. Co.*, 38 Iowa, 539; *Fitts v. Cream City R. R. Co.*, 59 Wis. 323. Compare *Murphy v. Bos-*

ton & A. R. R. Co., 133 Mass. 121; *Sweeny v. Old Colony, etc. R. R. Co.*, 10 Allen (Mass.), 368; *Johnson v. Boston, etc. R. R. Co.*, 125 Mass. 75; *Illinois Central R. R. Co. v. Godfrey*, 71 Ill. 500. Adverse to the statement in the text is *Sutton v. N. Y. C. & H. R. R. Co.*, 66 N. Y. 243.

⁴ *Commonwealth v. Power*, 7 Met. (Mass.) 596. See *Summit v. State*, 8 Lea (Tenn.), 413.

⁵ *Tobin v. Portland, etc. R. R. Co.*, 59 Me. 183; *Nagel v. Missouri Pac. Ry. Co.*, 75 Mo. 653; *Evansich v. G.*

passers, except not wantonly to injure them.¹ But the weight of authority seems to be in favor of the rule stated by the Federal Supreme Court as follows: "While a railway company is not bound to the same degree of care in regard to mere strangers who are unlawfully upon its premises that it owes to passengers conveyed by it, it is not exempt from responsibility to such strangers for injuries arising from its negligence or from its tortious acts."²

Accordingly, it would seem that a trespasser who is not guilty of contributory negligence should be allowed to recover if his injuries are caused by the negligence of the servants of the corporation. But there must have been negligence imputable to the corporation, for if no duty on its part is violated, there is no cause of action against it. And the circumstances are to be considered. Thus, to run a train rapidly and without signals across a highway crossing is in itself negligent; but not so to run the train at full speed and without continual whistling along the ordinary track.³ Except when crossing a highway, or passing through the streets of a town, the engineer of a train has no reason to expect persons on the track. Moreover, to be walking on a railroad track may itself constitute contributory negligence, barring recovery if the person is an adult.⁴ If, on the other hand, the person injured is a child, and its parents are free from fault, still, if it is walking on a railroad track, away from the public crossing, an engineer running over it might be

C. & S. F. Ry. Co., 37 Tex. 123; S. C., 61 Tex. 3; *Keffe v. Milwaukee and St. P. Ry. Co.*, 21 Minn. 207; Texas and St. L. Ry. *v. Orr*, 46 Ark. 182. But see *Pittsburgh, Ft. W. & C. Ry. Co. v. Bingham*, 29 O. St. 364.

¹ See also *Morrissey v. Eastern R. R. Co.*, 126 Mass. 377; *McAlpin v. Powell*, 55 How. Pr. (N. Y.) 163; *Hughes v. Macfie*, 2 H. & C. 744; *Mangan v. Atterton*, 4 H. & C. 388.

² *Railroad Co. v. Stout*, 17 Wall. 657, 661; *Benton v. C.*, R. I. and P. R. R. Co., 55 Iowa, 496; *Daley v. Norwich, etc. Railroad Co.*, 26 Conn. 591; *Whirley v. Whiteman*, 1 Head.

610; *Keffe v. Milwaukee, etc. Railroad Co.*, 21 Minn. 207; *Koons v. St. Louis, etc., Railroad Co.*, 65 Mo. 592; *T. and P. R'y Co. v. O'Donnell*, 58 Tex. 27; *Lynch v. Nurden*, 1 Q. B. 29; *Williams v. Great Western Railway Co.*, L. R., 9 Exch. 157. Compare *Opsahl v. Judd*, 30 Minn. 126; *Gradin v. St. Paul, etc. R'y Co.*, 30 Minn. 217.

³ See *St. Louis, etc. R'y Co. v. Payne*, 29 Kans. 166.

⁴ *Baltimore and Potomac R. R. Co. v. State*, 54 Md. 648; *Northern Central R'y Co. v. State*, ib. 113.

entirely free from negligence under circumstances that would have rendered the conduct of the engineer negligent indeed, had the accident occurred in a place where he was bound to keep a special lookout for travellers.¹

§ 373. The responsibility of corporations for injuries done by their employés, as diminished by the fact that the injured person was a trespasser, is closely connected with their liability as released by the contributory negligence of the injured person. The principle is, he whose own negligence occasions his injury cannot recover damages therefor.²

This rule connotes a statement often made as a qualification to it. Between the negligence of the plaintiff and his injury there must be the relation of ordinary and immediate antecedent and consequent, or what is usually called a causal relation. This qualification is also connoted by the term contributory. The plaintiff's negligence must have been the proximate not the remote cause or occasion of his injury.³

§ 374. The question of the negligence of the defendant, and the contributory negligence of the plaintiff, is ordinarily for the jury, under the direction of the court, to determine from the

¹ Philadelphia and Reading R. v. R. Co. v. Spearen, 47 Pa. St. 300, 303; Prendergast v. N. Y. C. & H. R. R. Co., 58 N. Y. 652.

² "Quod quis ex culpa sua damnum sentit, non intelligitur damnum sentire," Dig. lib. 50, tit. 17, § 203; see Wharton on Negligence, 2d ed., §§ 300 et seq., where the subject of contributory negligence is fully and satisfactorily treated.

Where a telegraph company incorrectly transmitted a message so that as transmitted it was unintelligible jargon, yet the receiver (the sender's agent) acted on it, the sender cannot hold the company for the loss, which was due to the negligent act of his own agent in acting on the message. Hart

v. Direct U. S. Cable Co., 86 N. Y. 633.

Not every degree of negligence, however slight, will bar a recovery; the negligence of the plaintiff to have this effect must amount to an absence of ordinary care. Strong v. Sacramento, etc. R. R. Co., 61 Cal. 326. Compare Kansas Pac. R'y Co. v. Peavey, 29 Kans. 169.

³ Kline v. Central Pac. R. R. Co., 37 Cal. 400; Flynn v. San Francisco, etc. R. R. Co., 40 Cal. 14; Murphy v. Deane, 101 Mass. 455; Trow v. Vermont Cent. R. R. Co., 24 Vt. 487; Pennsylvania R. R. Co. v. Richter, 42 N. J. L. 180; see Indianapolis and St. L. R. R. Co. v. Stout, 53 Ind. 143; Houston and T. C. Ry. Co. v. Smith, 52 Tex. 178.

circumstances of the case.¹ The circumstances of negligence cases are so diverse that a discussion of them would be of little practical value unless the greatest detail were gone into. On general principles, a person is not guilty of negligence or of contributory negligence for doing what he has a right to do.² Thus, every one has a right to cross the railroad track at a public crossing. To do so is not negligence. But if in so doing, a person does not make a vigilant use of his eyes and ears, he is negligent and cannot recover for injuries which would not have happened had he been vigilant.³

¹ *Railroad Co. v. Stout*, 17 Wall. 657; see *Hays v. Miller*, 70 N. Y. 112; *Lambert v. Staten Island R. R. Co.*, ib. 104; *Thurber v. Harlem, etc. R. R. Co.*, 60 N. Y. 331.

A statute may render inapplicable the general principles of the law of contributory negligence. Thus, in Michigan it is held that the liability of a railroad company for injuries to cattle resulting from its failure to fence its track, is not affected by the contributory negligence of the owner of the cattle. *Grand Rapids, etc. R. R. Co. v. Cameron*, 45 Mich. 451.

² Thus, a person is not guilty of contributory negligence in pasturing his horses—as he has a right to do—on a town-common, even though it be dangerous; and he may still recover from a railroad company if the latter injures them through its fault. *Chicago R. R. Co. v. Jones*, 59 Miss. 465; compare *Lindsay v. Winona, etc. R. R. Co.*, 29 Minn. 411. Likewise a railroad company has a right to use its own land for any legitimate purpose in the prosecution of its business. Such a use cannot be regarded as unlawful or negligent because it may obstruct the vision of those crossing the track. *Cordell v. N. Y. C. and H. R. R. Co.*, 70 N. Y. 119. A passenger is not ordinarily guilty of contributory

negligence in acting on the assumption that the carrier is not negligent. *Brassell v. New York C. & H. R. R. Co.*, 84 N. Y. 241; *Chaffee v. Boston & L. R. R. Co.*, 104 Mass. 108; *Baltimore & O. R. R. Co. v. State*, 60 Md. 449.

It is not contributory negligence for a passenger in a railroad car, with a headache, to support his head on his hand with his elbow resting on the sill of an open window. *Farlow v. Kelly*, 108 U. S. 288; *Germantown Passenger Ry. Co. v. Brophy*, 105 Pa. St. 38. But to ride with his arm outside the window is contributory negligence. *Todd v. Old Colony, etc. R. R. Co.*, 3 Allen (Mass.), 18; *S. C.*, 7 Allen (Mass.), 207.

³ *Salter v. Utica, etc. R. R. Co.*, 75 N. Y. 273; *Lake Shore and M. S. R. R. Co. v. Miller*, 25 Mich. 274; *International and G. N. Ry. Co. v. Graves*, 59 Tex. 330; *Pennsylvania R. R. Co. v. Richter*, 42 N. J. L. 180; *Terre Haute and I. R. R. Co. v. Clark*, 73 Ind. 168; *New Orleans, J. and G. R. R. Co. v. Mitchell*, 52 Miss. 808. Compare *Cleveland, C. and C. R. R. Co. v. Crawford*, 24 O. St. 631.

If a railroad crosses a common road on the same level, those travelling on either have a legal right to pass over

§ 375. Further, an act will not be negligent if at the time the person doing it was not a free agent;¹ or was a little child. This applies to persons who in a panic caused by an imminent collision on a railroad leap from the cars;² or to any person who instinctively does a sudden act to escape an imminent peril.³ In regard to a child, the caution and discretion required are according to its age and capacity.⁴ But in some instances the negligence of the persons having him in charge is held to bar a suit by his family, or his personal representatives, or perhaps by the child himself.⁵

§ 376. Regarding the burden of proof where contributory negligence is relied on by a defendant, the weight of authority is, that contributory negligence is matter of defence to be alleged and proved by the defendant.⁶ But a number of decisions hold a contrary doctrine.⁷

the point of crossing, and to require due care from those travelling on the other to avoid collisions. The train has the preference and right of way; but is bound to give due warning. *Continental Improvement Co. v. Stead*, 95 U. S. 161. See *Railroad Co. v. Houston*, ib. 697; *Shaw v. Boston and W. R. R. Co.*, 8 Gray (Mass.), 45; *Black v. Burlington, etc. Ry. Co.*, 38 Iowa, 515.

¹ See Wharton on Neg., 2d ed., §§ 301 *et seq.*

² *Frink v. Potter*, 17 Ill. 406.

³ *Larrabee v. Sewall*, 66 Me. 376; *Indianapolis, etc. R. R. Co. v. Carr*, 35 Ind. 510; *Stokes v. Saltonstall*, 13 Pet. 181. See *Eckert v. Long Island R. R. Co.*, 43 N. Y. 502.

⁴ *Railroad Co. v. Gladmon*, 15 Wall.

401; Same *v. Stout*, 17 Wall. 657; *Chicago and A. R. R. Co. v. Becker*, 76 Ill. 25; *Daniels v. Clegg*, 28 Mich. 33; *Dowd v. Chicopee*, 116 Mass. 93; *Wendell v. New York Cent. and H. R. R. Co.*, 91 N. Y. 420.

⁵ *Fitzgerald v. St. Paul, etc. R'y Co.*, 29 Minn. 336.

Here the authorities are very conflicting. The question is discussed at length, with a full citation of authorities in Wharton on Neg., 2d ed., §§ 310 *et seq.*

⁶ *Railroad Co. v. Gladmon*, 15 Wall. 401; *Indianapolis, etc. R. R. Co. v. Horst*, 93 U. S. 291; *Durant v. Palmer*, 29 N. J. L. 544; *Penn. Canal Co. v. Bentley*, 66 Pa. St. 30; *Cleveland and Pittsburgh R. R. Co. v. Rowan*, 66 Pa. St. 393; *Pennsylvania*

⁷ *Murphy v. Deane*, 101 Mass. 457; *Lake Shore, etc. R. R. Co. v. Miller*, 25 Mich. 274; *Daniels v. Clegg*, 28 Mich. 33; *Tolman v. Syracuse, etc. R. R. Co.*, 98 N. Y. 198; *Button v. Hudson River R. R. Co.*, 18 N. Y.

248; *Warner v. New York Cent. R. R. Co.*, 44 N. Y. 465; *Owens v. Richmond, etc. R. R. Co.*, 88 N. C. 502. See *Wheelock v. Boston and Albany R. R. Co.*, 105 Mass. 203.

§ 377. In assessing damages against a corporation for personal injuries caused by the negligence or other wrongful acts of its servants, the measure of damages is the same as in actions against individual principals or masters. According to the law as declared in the majority of the states, exemplary damages may be allowed against a corporation;¹ but only when the wrongful act was done wilfully, or with that indifference to the rights of others which is equivalent to an intentional violation of them.²

Damages recoverable. Exemplary damages.

R. R. Co. v. Weber, 76 Pa. St. 157; Weiss v. Pennsylvania R. R. Co., 79 Pa. St. 387; Frech v. Phila., W. and B. R. R. Co., 39 Md. 574; State v. Balto. and Potomac R. R. Co., 58 Md. 482; Smoot v. Wetumpka, 24 Ala. 112; Strahlendorf v. Rosenthal, 30 Wis. 675; Kansas Pac. R'y Co. v. Pointer, 14 Kans. 37; Kansas City L. & S. R. R. Co. v. Phillibert, 25 Kan. 582; Baltimore and O. R. R. Co. v. Whittington, 30 Grat. (Va.) 805; Thompson v. Duncan, 76 Ala. 334; Thompson v. North Missouri R. R. Co., 51 Mo. 190; St. Anthony Falls Co. v. Eastman, 20 Minn. 277; McQuilken v. Cent. Pac. R. R. Co., 50 Cal. 7; MacDougal v. Central R. R. Co., 63 Cal. 431; Paducah, etc. R. R. Co. v. Hoehl, 12 Bush (Ky.), 42; Texas and Pac. R. R. Co. v. Murphy, 46 Tex. 356; Evansville, etc. R. R. Co. v. Hiatt, 17 Ind. 102; Hathaway v. Toledo, etc. R. R. Co., 46 Ind. 25; Jackson v. Indianapolis, etc. R. R. Co., 47 Ind. 454; Higgins v. Jeffersonville, etc. R. R. Co., 52 Ind. 110; Galena, etc. R. R. Co. v. Fay, 16 Ill. 558; Baird v. Morford, 29 Iowa, 531; Reynolds v. Hindman, 32 Iowa, 146; Patterson v. B. and M. R. R. Co., 38 Iowa, 279; Fowler v. Baltimore and O. R. R. Co., 18 W. Va. 579; Street R. R. Co. v. Nolthenins, 40 O. St. 376.

Compare Hinckley v. Cape Cod R. R., 120 Mass. 257.

Circumstances may make out a *prima facie* case of contributory negligence, thus throwing on the plaintiff the burden of proving due care. See Allyn v. Boston and Albany R. R. Co., 105 Mass. 77; Johnson v. Hudson River R. R. Co., 20 N. Y. 65.

¹ Phila. W. and B. R. R. Co. v. Larkin, 47 Md. 155; Gasway v. Atlanta, etc. R'y Co., 58 Ga. 216; Western Un. Tel. Co. v. Eyser, 2 Col. 141; Hinckley v. Chicago, etc. R'y Co., 38 Wis. 194; Taylor v. Grand Trunk R'y Co., 48 N. H. 304; Malecek v. Tower Grove, etc. R'y Co., 57 Mo. 17; Beale v. Railway Co., 1 Dill. 568; Singer M'fg Co. v. Holdfodt, 86 Ill. 455; Atlantic, etc. R'y Co. v. Dunn, 19 Ohio St. 162; Hopkins v. Atlantic, etc. R. R. Co., 36 N. H. 9; Allbritton v. J. & G. N. R. R. Co., 38 Miss. 242; compare Craker v. Chicago and N. W. R'y Co., 36 Wis. 657; Pittsburgh, Ft. W. and C. R. R. Co. v. Slusser, 19 Ohio St. 157; Chicago R. R. Co. v. Scurr, 59 Miss. 456; Same v. Jarrett, ib. 470; Trigg v. St. Louis, etc. R'y Co., 74 Mo. 147.

² Milwaukee, etc. R. R. Co. v. Arms, 91 U. S. 489; Holmes v. Carolina Central R. R. Co., 94 N. C.

§ 378. The doctrine of other cases, however, is to the general effect that to justify the allowance of exemplary damages against a corporation, the superior corporate agents must either have been negligent in their choice of employes, or must have ratified the act in some way, *e. g.*, by retaining the servant in the employ of the company. As said by the late Chief Judge Church, giving the opinion of the New York Court of Appeals in *Cleghorn v. New York Central Railroad Co.*:¹ "For injuries by the negligence of a servant while engaged in the business of the master, within the scope of his employment, the latter is liable for compensatory damages; but for such negligence, however gross or culpable, he is not liable to be punished in punitive damages, unless he is also chargeable with gross misconduct. Such misconduct may be established by showing that the act of the servant was authorized or ratified, or that the master employed or retained the servant, knowing that he was incompetent, or, from bad habits, unfit for the position he occupied. Something more than ordinary negligence is required; it must be reckless and of a criminal nature, and clearly established. Corporations may incur this liability as well as private persons.² If a railroad company, for instance, knowingly and wantonly employs a drunken engineer, or switchman, or retains one after knowledge of his habits is clearly brought home to the company, or to a superintending agent authorized to employ and discharge him, and injury occurs by reason of such habits, the company may and ought to be amenable to the severest rule of damages; but I am not aware of any principle which permits a jury to award exemplary damages in a case which does not come up to this standard, or to graduate the amount of such damages by their view of the propriety of the conduct of the defendant, unless such conduct is of the character before specified."³

318. See *Baltimore, etc. Turnpike Co. v. Boone*, 45 Md. 344; *Belknap v. Boston and M. R. R. Co.*, 49 N. H. 358; *Louisville, etc. R'y Co. v. Shanks*, 94 Ind. 598; *South & North Ala. R. R. Co. v. McLendon*, 63 Ala. 266.

¹ 56 N. Y. 44, 47.

² Citing *Caldwell v. N. J. Steamboat Co.*, 47 N. Y. 282.

³ Accord, *Goddard v. Grand Trunk R'y*, 57 Me. 202; *Perkins v. Missouri, etc. R. R. Co.*, 55 Mo. 201; *Hays v. Houston, etc. R. R. Co.*, 46 Tex. 272;

New Orleans, etc. R. R. Co. *v.* Burke, 53 Miss. 201; *Hinckley v. Chicago M. & St. P. R'y Co.*, 38 Wis. 194. Compare *Townsend v. N. Y. C. and H. R. R. Co.*, 56 N. Y. 295; *Edleman v. St. Louis Transfer Co.*, 3 Mo. App. 503. A legislature cannot by statute restrict the amount recoverable from railroad companies for personal injuries caused by their negligence. *Passenger R'y Co. v. Boudrou*, 92 Pa. St 475. (Of course, a very different case from that where a legislature creates the right of action for injuries resulting in death and limits the amount of damage recoverable.)

PART V.

I. LEGAL EFFECT OF ACTS DONE WITHOUT THE STATE
INCORPORATING THE CORPORATION.

The two questions, § 379.

Legal effect of the act within the limits of the home state, §§ 380-382.

Legal effect of the act in the foreign state, § 383.

Comity among states, § 384.

Limits to this comity, § 385.

Foreign corporations cannot exercise special franchises, § 386 ;

Nor act contrary to the laws or public policy of the state, §§ 387, 388 ;

Nor do acts beyond their powers, §§ 389-391.

Actions against foreign corporations, § 392.

Penal provisions not enforced outside the state enacting them. Statutory liability, § 393.

Jurisdiction over assets of foreign corporations, § 394.

Service on foreign corporations, §§ 395, 396.

Statutes regulating service, § 397.

New York doctrine, § 398.

Proceedings *in rem*, § 399.

Statutes imposing terms on foreign corporations, § 400.

Effect of non-compliance with these statutes, § 401.

Statute of limitations, § 402.

§ 379. THIS topic relates to the territorial extent of corporate powers, and involves a consideration of two distinct questions. When an act is done by or on behalf of a corporation outside of the state incorporating it, what is the legal effect of that act (1) in the state incorporating the corporation ; (2) in the state where the act was done ?

§ 380. Within the limits of the state incorporating the corporation, the legal effect of an act done without the limits of that state depends primarily on a construction of the provisions in the corporate constitution regarding the corporate powers. The question will be, do the corporate powers authorize the given act to be done beyond the limits of the state ? " It may safely be assumed that a corporation can make no contract, and do no acts, either within or without the state which creates it, except such as are authorized by its charter ; and these acts must also be done by such officers or agents, and in such manner, as the charter

Legal effect of the act within the limits of the home state.

authorizes.”¹ If the corporate powers authorize the act to be done outside the state, it will be valid as to all persons within the jurisdiction of the state.² If they do not authorize the act to be so done, the rules applicable to *ultra vires* acts generally will apply; though the fact that the act was done outside of the state will not prejudice any person, acting on the faith of the act, who had no reason to know that it was done outside the state.³

§ 381. It may be stated as a proposition of general truth and applicability, that with respect to the jurisdiction of the state incorporating the corporation, acts done on behalf of the corporation, if done outside the state, are valid, in the absence of special restriction;⁴ for a grant of franchises without restriction is equivalent to a specific authority to exercise them wherever the corporation may find it convenient or profitable to do so.⁵ Accordingly, directors may act as a board outside the state limits.⁶

¹ Taney, C. J., in *Bank of Augusta v. Earle*, 13 Pet. 588. “Its residence in one state creates no insuperable objection to its power of contracting in another.” *Ib.* See *Ewing v. Toledo S’v’gs Bk.*, 43 O. St. 31; *Angell and Ames on Corp.* § 104.

The two cases of *Middle Bridge Co. v. Marks*, 26 Me. 326, and *Miller v. Ewer*, 27 Me. 509, seem to imply that it is incompetent for a legislature to authorize a corporation to act outside the boundaries of the state. But this seems incomprehensible. Chap. 468 of the New York Statutes of 1881, is entitled “An act to authorize the formation of corporations for the purpose of acquiring, constructing, and operating railroads in foreign countries.” And *Merrick v. Van Santvoord*, 34 N. Y. 208, holds that the charter of a corporation may confer powers without territorial limitation, which, accordingly, may be exercised beyond the jurisdiction of the sovereign granting the charter.

² *Hutchins v. New England Coal M’g Co.*, 4 Allen, 580.

³ *Galveston Railroad v. Cowdrey*, 11 Wall. 459. This on principles regulating the effect of acts apparently within the scope of the corporate powers, §§ 284-286.

⁴ *Bank of Augusta v. Earle*, 13 Pet. 519, 588; *Hutchins v. New England Coal M’g Co.*, 4 Allen, 580; *Blair v. Perpetual Ins. Co.*, 10 Mo. 559; *New York Floating Derrick Co. v. New Jersey Oil Co.*, 3 Duer (N. Y.), 648; *Tombigbee R. R. Co. v. Kneeland*, 4 How. 16; *Wood Hydraulic Hose M’g Co. v. King*, 45 Ga. 34; *Dodge v. City of Council Bluffs*, 57 Iowa, 560; see *Mumford v. Am. Life Ins., etc. Co.*, 4 N. Y. 463.

⁵ *Merrick v. Van Santvoord*, 34 N. Y. 208; *Kerchner v. Gettys*, 18 S. C. 521; *Atchison T. & S. F. R. R. Co. v. Fletcher*, 35 Kan. 236.

⁶ *Galveston Railroad v. Cowdrey*, 11 Wall. 459; *Bellows v. Todd*, 39 Iowa, 209; *Arms v. Conant*, 36 Vt.

§ 382. The rule is otherwise in regard to the acts of the body corporate itself. These, when done beyond the limits of the state, are ordinarily held invalid.¹ It is submitted, however, that the reason of this does not lie in the imaginative notion that a corporation "must dwell in the place of its creation, and cannot migrate to another sovereignty;"² but rather in the hardship and fraud it might entail on shareholders to permit corporate meetings to be held outside the state. Accordingly, there seems to be no reason for holding invalid acts done at corporate meetings assembled without the state, if all the shareholders acquiesce in the holding of such meetings.³

§ 383. A different question is the one regarding the legal effect of the act within the limits of the state where it was done. There the legal effect depends ordinarily on whether that state will give effect to provisions of the act within the limits of the state where it was done. There the legal effect depends ordinarily on whether that state will give effect to provisions of the act within the limits of the state where it was done.

Legal effect
of the act
in the for-
eign state.

745; *Bassett v. Monte Christo M. Co.*, 15 Nev. 293; *Ohio and Miss. R. R. Co. v. McPherson*, 35 Mo. 13; *Wright v. Bundy*, 11 Ind. 398; *McCall v. Byram M'f'g Co.*, 6 Conn. 428; *Wood Hydraulic Hose M'g Co. v. King*, 45 Ga. 34; *Smith v. Alvord*, 63 Barb. 415; *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439, 450. See *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339; *Smith v. Silver Valley M'g Co.*, 64 Md. 86. Compare, however, *Hilles v. Parrish*, 14 N. J. Eq. 380. To the contrary is an unconsidered dictum in *Ormsby v. Vermont Copper M'g Co.*, 56 N. Y. 623, a case not reported in full.

¹ *Miller v. Ewer*, 27 Me. 509; *Aspinwall v. Ohio, etc. R. R. Co.*, 20 Ind. 492; *Freeman v. Machias Water Power Co.*, 38 Me. 343; *Ormsby v. Vermont Copper M'g Co.*, 56 N. Y. 623. Compare *Copp v. Lamb*, 12 Me. 312. No legal organization of a corporation can be effected by action taken outside of the state granting the charter. *Freeman v. Machias Water Power Co.*, *supra*. *Smith v. Silver*

Valley M'g Co., 64 Md. 86. Compare *Camp v. Byrne*, 41 Mo. 525. Authority in charter to transact business at points without the state, does not authorize acts by the corporation directly, such as corporate meetings. An election of directors by a corporate meeting held outside the state is void. A shareholder is not bound by a by-law passed by directors elected without the state, although his own shares were voted, by proxy, at the meeting which elected the said directors. *Franco-Texan Land Co. v. Laigle*, 59 Tex. 339.

² *Bank of Augusta v. Earle*, 13 Pet. 519, 588, per Taney, C. J. It is held that a corporation dwells in the place where its business is carried on. *Taylor v. Gas and Coke Co.*, 11 Ex. 1; see *Connecticut and Passumpsic Rivers R. R. Co. v. Cooper*, 30 Vt., 476, 481; *Stout v. Sioux City, etc. R. R. Co.*, 3 McCrary 1; but see *Plimpton v. Bigelow*, 93 N. Y. 592, reversing S. C., 12 Abb. N. C. (N. Y.) 202.

³ See *Camp v. Byrne*, 41 Mo. 525.

sions in the laws of the state incorporating the corporation. For corporations are not citizens within the meaning of the provision in the Federal Constitution guaranteeing to the citizens of each state all the privileges and immunities of citizens in the several states;¹ and, accordingly, a state may prohibit a corporation incorporated by another state from contracting within the limits of the former.² "Every power which a corporation exercises in another state depends for its validity upon the laws of the sovereignty in which it is exercised, and no corporation can make a valid contract without the sanction, express or implied, of such sovereignty; unless a case should be presented in which the right claimed by the corporation should appear to be secured by the Constitution of the United States."³

¹ Art. IV. § 2.

² *Paul v. Virginia*, 8 Wall. 168; *Lafayette Ins. Co. v. French*, 18 How. 404, 407; *Ducat v. Chicago*, 10 Wall. 410; *Liverpool Ins. Co. v. Massachusetts*, ib. 566; *Doyle v. Continental Ins. Co.*, 94 U. S. 535; *Warren M'fg Co. v. Ætna Ins. Co.*, 2 Paine, 501; *Home Ins. Co. v. Davis*, 29 Mich. 238; *Commonwealth v. Milton*, 12 B. Mon. (Ky.) 212; *Phoenix Ins. Co. v. Commonwealth*, 5 Bush (Ky.), 68; *Gill's Adm. v. Kentucky*, etc. *Gold M'g Co.*, 7 Bush, 635; *Matthews v. Trustees*, 2 Brewst. (Pa.) 541; *Fire Dept. v. Noble*, 3 E. D. Smith (N. Y.), 449; *Slaughter v. Commonwealth*, 13 Gratt. (Va.) 767; *Western Union Tel. Co. v. Mayer*, 28 Ohio St. 521. See *Milnor v. N. Y. and N. H. R. R. Co.*, 53 N. Y. 363; *People v. Fire Ass'n*, 92 N. Y. 311; *Tatem v. Wright*, 23 N. J. L. 429; also § 480.

But it is doubtful, when congress has conferred on a railroad corporation created by a state the power to construct its road within an organized territory, whether such territory after it

has become a state can impose any impediment to the full enjoyment of the right thus conferred. *Van Wyck v. Knevals*, 106 U. S. 360, 369; *Railroad Co. v. Baldwin*, 103 U. S. 426. "It could only do this on the same terms that it could refuse a recognition of its own previously granted right, for in such matters the state would succeed only to the authority of congress over the territory." *Railroad Co. v. Baldwin*, 103 U. S. 426, 431.

³ *Runyan v. Coster's Lessee*, 14 Pet. 122, 129. A state cannot deny to a corporation any right protected by the Federal constitution; see *Erie R. Co. v. State*, 31 N. J. L. 531; *State v. American Exp. Co.*, 7 Biss. 230; and see § 400. Nor can state legislation restrict foreign corporations when by so doing it interferes with Federal powers, as, *e. g.*, the power to regulate interstate commerce. See *Pensacola Tel. Co. v. Western Un. Tel. Co.*, 96 U. S. 1; *American Un. Tel. Co. v. Western Un. Tel. Co.*, 67 Ala. 26; also § 480.

Comity among states. § 384. The right, however, of a state to exclude foreign corporations and prevent them from making contracts or transacting business within the state is not ordinarily exercised; and the general rule may be stated, subject to qualifications hereafter to be mentioned, that the various states of the Union will permit foreign corporations, which are not expressly or impliedly forbidden by their respective constitutions to transact business outside of the state incorporating them, to contract and transact such business as their constitutions authorize them to execute; and to resort to the state courts for the enforcement of their rights.¹ This general rule was first authoritatively expressed in *Bank of Augusta v. Earle*,² as follows: "We think it is well settled that by the law of comity among nations, a corporation created by one sovereignty is permitted to make contracts in another, and to sue in its courts; and that the same law of comity prevails among the several sovereignties of this Union. The public and well-known and long-continued usages of trade, the general acquiescence of the states, the particular legislation of some of them, as well as the legislation of congress, all concur in proving the truth of this proposition." In *Christian Union v. Yount*,³ the rule was restated thus: "In harmony with the general law of comity, obtaining among the states composing the Union, the presumption should be indulged that the corporation of one state, not forbidden by the law of its being, may exercise within any other state the general powers conferred by its own charter, unless it is prohibited from so doing either in the direct enactments of the latter state, or by its public policy to be deduced from the general course of its legislation, or from the settled adjudications of its highest court."⁴

¹ A foreign corporation in suing need not set out in its pleading the terms of its charter showing its capacity to maintain the action. *Smith v. Weed Sewing Machine Co.*, 26 Ohio St. 563. It is not against public policy to organize a corporation to act as the agent within the state of a foreign corporation. *Day v. Postal Telegraph Co.*, 66 Md. 355.

² 13 Pet. 519, 592, per Taney, C. J.

³ 101 U. S. 352, 356, per Harlan, J.

⁴ In accordance with these principles are the following authorities: *Tombigbee R. R. Co. v. Kneeland*, 4 How. 16; *Cowell v. Spring Co.*, 100 U. S. 55; *Williams v. Creswell*, 51 Miss. 817; *Silver Lake Bank v. North*,

§ 385. The general rule is subject to the following qualifications: The comity between states does not extend so far that

4 Johns. Ch. (N. Y.) 370; *Bard v. Poole*, 12 N. Y. 495; *Merrick v. Van Santvoord*, 34 N. Y. 208; *British Am. Land Co. v. Ames*, 6 Mete. 391; *Martin v. Mobile, etc. R. R. Co.*, 7 Bush (Ky.), 116; *Guaga Iron Co. v. Dawson*, 4 Blackf. (Ind.) 202; *Leasure v. Union Mut. Life Ins. Co.*, 91 Pa. St. 491; *Dodge v. City of Council Bluffs*, 57 Iowa, 560; *Life Ass'n v. Levy*, 33 La. Ann. 1203; *Kennebec Co. v. Augusta Ins. Co.*, 6 Gray, 204; *Flash v. Conn*, 16 Fla. 428; *Newburg Petroleum Co. v. Weare*, 27 Ohio St. 343; *Bank of Washtenaw v. Montgomery*, 3 Ill. 422; *Lycoming Fire Ins. Co. v. Langley*, 62 Md. 196. See *Mut. Ben. Life Ins. Co. v. Davis*, 12 N. Y. 569; *Eslava v. Ames Plow Co.*, 47 Ala. 384. A foreign corporation may sue as administrator in Delaware when authorized by the state creating it (Pennsylvania) to administer decedents' estates. *Deringer's Adm'r v. Deringer's Adm'r*, 5 Houst. (Del.) 416.

When there is nothing to the contrary in the policy of the state as declared by its legislature, a foreign corporation may purchase real estate. *Cowell v. Springs Co.*, 100 U. S. 55; *Christian Union v. Yount*, 101 U. S. 352; *State v. Boston, Concord, etc. R. R. Co.*, 25 Vt. 433; *Claremont Bridge Co. v. Royce*, 42 Vt. 730; *Thompson v. Waters*, 25 Mich. 214; *Lumbard v. Aldrich*, 8 N. H. 30; *Santa Clara Female Academy v. Sullivan*, 116 Ill. 375. See *Runyan v. Coster's Lessee*, 14 Pet. 122; *Whitman M'g Co. v. Baker*, 3 Nev. 386. A foreign cor-

poration may take a lease of premises for its business. *Steamboat Co. v. McCutcheon*, 13 Pa. St. 13; *Northern Trans'n Co. v. Chicago*, 7 Biss. 45; *Black v. Delaware and R. Canal Co.*, 22 N. J. Eq. 130, 422. Or a mortgage on real estate. *National Trust Co. v. Murphy*, 30 N. J. Eq. 408; *Lebanon Savings Bank v. Hollenbeck*, 29 Minn. 322; *American Mut. Life Ins. Co. v. Owen*, 15 Gray, 491; *Silver Lake Bank v. North*, 4 Johns. Ch. 370; *Lathrop v. Commercial Bank*, 8 Dana (Ky.), 114; *New York Dry Dock v. Hicks*, 5 McLean, 111; *Farmers' Loan and Trust Co. v. McKinney*, 6 McLean, 1; *Life Ins. Co. v. Overholt*, 4 Dill. 287. See *Leasure v. Union Mut. Life Ins. Co.*, 91 Pa. St. 491. A foreign corporation, in whose favor a foreclosure decree is rendered, may hold and convey real estate purchased under the decree, when there is no prohibitory statute. *Elston v. Piggott*, 94 Ind. 14.

This rule does not enable a corporation to exercise in a foreign state powers not granted to it by its constitution. ✓
Pierce v. Crompton, 13 R. I. 312. See *Thompson v. Waters*, 25 Mich. 214, and §§ 389-391 *post*.

The comity of a state does not extend so far as to allow a foreign corporation, authorized by its constitution to do business in any state except the state incorporating it, to transact business within the limits of the former state. *Land Grant R'y Co. v. Commissioners*, 6 Kans. 245; compare *Hanna v. International Petroleum Co.*, 23 Ohio St. 622.

a state will allow a foreign corporation to (1) exercise any extraordinary franchises, or (2) do any act contrary to the laws, or the public policy of the state as indicated by its legislation, or (3) any act unauthorized by the constitution of the corporation. Moreover, in applying general principles of corporation law to contracts made or to be performed by a foreign corporation within the state, its courts will not necessarily follow the decisions of the state that incorporated the corporation.¹

§ 386. (1) It has never been held or intimated that a state would permit a foreign corporation to exercise any extraordinary franchise or special privilege granted by the state incorporating it; as, for instance, the right of eminent domain, or the privilege of exemption from taxation. Rather, it may be stated with confidence, that the direct contrary is the law.² It has even been said that a contract of a foreign corporation to be valid "must be one which would be valid if made at the same place by a natural person not a resident of the state."³

§ 387. (2) The act or contract must not be contrary to the laws of the state. Accordingly, if those laws forbid devises to corporations, a devise to a foreign corporation is invalid, although by its constitution it may be authorized to take in that manner.⁴

On similar principles foreign corporations in transacting business must conform to the usury laws of the state; although by their constitutions they are permitted to take a higher rate of interest.⁵ Likewise a foreign corporation

¹ *Milnor v. N. Y. and N. H. R. R. Co.*, 53 N. Y. 363.

² Foreign railroad company cannot exercise the right of eminent domain; *Holbert v. St. L. R. C. and N. R. Co.*, 45 Iowa, 23. See *State v. Boston, Concord, etc. R. R. Co.*, 25 Vt. 433, 442; *Middle Bridge Co. v. Marks*, 26 Me. 326.

³ *Bard v. Poole*, 12 N. Y. 495, 505. Without express permission a foreign

corporation cannot carry on a business not open to individuals. *People v. Howard*, 50 Mich. 239.

⁴ *Starkweather v. Am. Bible Soc'y*, 72 Ill. 50; *Boyce v. St. Louis*, 29 Barb. 650; *White v. Howard*, 46 N. Y. 144; *United States v. Fox*, 94 U. S. 315. Compare § 391.

⁵ *Hitchcock's Heirs v. United States Bank*, 7 Ala. 386, 485.

is subject to the penal laws of the state in which it carries on its operations.¹

§ 388. Neither will a state permit foreign corporations by their acts to contravene its public policy as evinced by its legislation.² But this public policy must be clear and positive. "If the policy of the state or territory does not permit the business of the foreign corporation within its limits, or allow the corporation to acquire or hold real property, it must be expressed in some affirmative way; it cannot be inferred from the fact that its legislature has made no provisions for the formation of similar corporations, or allows corporations to be formed only by general law."³

§ 389. (3) The third qualification is often stated thus: "The contract must be one which the foreign corporation is permitted by its charter to make."⁴ It will be noticed that the word "charter" is used here in a manner to imply that any disability imposed on a foreign corporation by the general laws of the state creating it, would be disregarded by the courts of another state. And, indeed, this distinction is expressly taken in *Hoyt v. Sheldon*,⁵ where it is said: "There is a plain distinction between acts of the foreign corporation, which the charter does not authorize, ✓

Nor do acts beyond their powers.

¹ *McGregor qui tam v. Erie R'y Co.*, 35 N. J. L. 115; *Hines v. Wilmington, etc. R. R. Co.*, 95 N. C. 434.

² See *Ewing v. Toledo Sav'gs Bk.*, 43 O. St. 31. Illinois decisions afford illustrations of this principle. In that state the public policy is declared against perpetuities in lands, and the Illinois courts hold that a foreign corporation, which is authorized by its charter to buy and sell lands, without any provision to compel it to sell within a certain time, cannot purchase land in Illinois, as that might tend to create a perpetuity. *Carroll v. East St. Louis*, 67 Ill. 568; *United States Trust Co. v. Lee*, 73 Ill. 142. But it has since been held by the Illinois Supreme Court that this rule does not apply to corporations incorporated to loan

money on real estate securities. *United States Mortgage Co. v. Gross*, 7 Central L. J. 226 (1878). See also cases in the next note.

³ *Cowell v. Spring Co.*, 100 U. S. 55, 59; approved in *Christian Union v. Yount*, 101 U. S. 352, 356. *Accord Stevens v. Pratt*, 101 Ill. 206; *Commercial Union Assurance Co. v. Scammon*, 102 Ill. 46. And see *Carroll v. East St. Louis*, 67 Ill. 568.

⁴ *Bard v. Poole*, 12 N. Y. 495, 505; *Hitchcock's Heirs v. United States Bank*, 7 Ala. 386, 435; *Morris v. Hall*, 41 Ala. 510. See also *Pierce v. Crompton*, 13 R. I. 312; *Thompson v. Waters*, 25 Mich. 214. See *Deringer v. Deringer*, 5 Houston (Del.), 416, *ante*, last n. to § 384.

⁵ 3 Bos. (N. Y.) 267, 299.

or which it may forbid, and acts which upon the face of the charter are authorized, but which the general laws of the foreign state may prohibit." From the context, however, it is apparent that the court did not mean to lay down any general rule to the effect that courts would not recognize restrictions on the powers of foreign corporations contained in the general laws of the state incorporating them; but only that persons dealing with the corporation would not be affected with notice of such provisions. The court continue, as follows: "Our citizens acting here in dealing with or in relying upon the acts of such a corporation, are bound to notice and regard the provisions of such charter, but are not affected by or bound to notice the general laws of the foreign state, although they may restrain the powers of such corporations under the charter."¹ An examination of the same case on appeal² will show that if the citizen of New York, in this instance, had had notice of the foreign law, the New York court would have given full effect³ to it, and would have recognized the disabilities imposed by it on the foreign corporation.³

§ 390. Admitting it to be proper for the courts of a state to protect its own citizens from the hardships they might suffer were they bound to know the laws of a foreign state,⁴ it is submitted that the distinction indicated above is neither convenient nor correct on principle. It is not convenient, for nowadays the vast majority of corporations are incorporated under general

¹ *Ib.* A court will not take judicial notice of the powers of a foreign corporation. *Chapman v. Colby*, 47 Mich. 46. The corporation must prove its powers. *Diamond Match Co. v. Powers*, 51 Mich. 145.

² 19 N. Y. 207, 222, *sub nom.* *Hoyt v. Thompson's Executor*. Compare *Hoyt v. Thompson*, 5 N. Y. 320, 353.

³ The New York Court of Appeals seems not to have adhered to the above distinction in the case of *Ellsworth v. St. Louis, etc. R. R. Co.*, 98 N. Y. 553. There it was decided that when a railroad company incorporated by another state enters into a

contract in New York, which, by its terms, is to be performed in New York and is legal under New York laws, prohibitions in the charter which would render the contract illegal in the state incorporating the company, do not render it illegal in New York; but operate only as restrictions on the power of the corporation and its officers.

⁴ See § 389. But compare *Relfe v. Rundle*, 103 U. S. 222, 224; and *Bockover v. Life Association*, 77 Va. 85, which holds that every one dealing with a corporation, even in a foreign state, must take notice of its powers.

statutes, and have no "charters" properly speaking; so the distinction is fast losing its applicability. And the distinction seems incorrect on principle; it being a curious comity which will recognize in corporations powers which, under their own constitutions, they do not possess. The constitution of a corporation is composed of all the laws affecting the corporation; and embraces just as much statutes affecting corporations generally, as the particular statute—enabling act or special charter—immediately under which the corporation was organized.¹

§ 391. The correct distinction seems rather as follows: If the validity of an act, forbidden by the legislature of the state incorporating the foreign corporation on whose behalf or in regard to which the act was done, is to be passed on by the court of another state, by the true rule of comity the court should give effect to the prohibition according to the intent of the legislature enacting it. If the prohibition were apparently intended to inhere in the corporation, and to apply to all its acts wherever done, the court should give effect to it. But if it was rather part of the local policy of the state enacting it, of local policy which there is no reason for extending beyond state limits, nor even any reason for supposing the legislature would have desired to see thus extended, then the prohibition should not be enforced by the courts of other states, at least in regard to acts and matters outside of the state enacting it.² The true rule was stated by Justice Christiancy in *Thompson v. Waters*,³ to the effect that a court will recognize in a foreign corporation "no powers or capacities which would not be recognized and sustained by the courts of" the state incorporating it, "had the same question of capacity to take *these* lands come before them for adjudication."

¹ *Relfe v. Rundle*, 103 U. S. 222. Compare *Canada Southern R. R. Co. v. Gebhard*, 109 U. S. 527, 537.

The ordinary presumptions in favor of the legality of actions, however, apply to foreign corporations. Thus, where a court has no judicial knowledge of the constitution of the foreign corporations, as, *e. g.*, when it is chartered by a private law, the court will

presume authority to do any reasonable act, until absence of authority be shown. *Charleston, etc. Turnpike Co. v. Willey*, 16 Ind. 34. See also *Express Co. v. Railroad Co.*, 99 U. S. 191, 199.

² See *Ohio Life Ins. Co. v. Merchants' Ins. Co.*, 11 Humph. (Tenn.) 1, 24.

³ 25 Mich. 214, 218.

This latter distinction finds illustration in decisions construing the validity of devises of lands to foreign corporations. If, for instance, in Ohio, certain corporations are allowed to take land by devise, a prohibition in the laws of the state incorporating the foreign corporation will not invalidate a devise to it of Ohio land.¹ Indeed, is there any reason to suppose that the courts of the state incorporating the corporation would apply its own statute forbidding devises to corporations, to invalidate a devise to the corporation of land situated in a state where no such prohibition existed? Would they not rather apply the law of the state where the land was situated? assuming such a question to be brought before them, which is improbable.

§ 392. As the courts of a state will enforce contracts at the suits of a foreign corporation, so they will entertain an action against it.² But the subject-matter of the suit must not be such that the court will decline to assume jurisdiction, as, for instance, on account of its inability to do complete justice in the matter.³

Actions
against
foreign cor-
porations.

In New York, section 1780 of the Code of Civil Procedure

¹ Am. Bible Soc'y v. Marshall, 15 Ohio St. 537; White v. Howard, 38 Conn. 342. Compare § 386.

² N. O. J. and G. N. R. Co. v. Wallace, 50 Miss. 244; North Missouri R. R. Co. v. Akers, 4 Kans. 453; City Fire Ins. Co. v. Carrugi, 41 Ga. 660; Bushel v. Commonwealth Ins. Co., 15 S. & R. 176; St. Louis Perpetual Ins. Co. v. Cohen, 9 Mo. 416, 441; Newby v. Colt's Patent Fire Arms Co., L. R. 7 Q. B. 293; Libbey v. Hodgdon, 9 N. H. 394; Equitable Life Ass. Soc. v. Vogel's Executrix, 76 Ala. 441; Selma, etc. R. R. Co. v. Tyson, 48 Ga. 351.

The stock (i. e., shares) of a foreign corporation having its office and principal business within this state (New York), is not subject here to attachment as property within this state, the owner being a non-resident, and his

certificate never having been within this state. Plimpton v. Bigelow, 93 N. Y. 592, reversing S. C., 12 Abb. N. C. (N. Y.) 202. Compare Schmidlapp v. La Confiance Ins. Co., 71 Ga. 246. Contra, Young v. Iron Co., 85 Tenn. 189. Foreign corporations are subject to garnishment only where an original action could be begun against them in the same courts to recover the debt garnisheed. Myer v. Liverpool, etc. Ins. Co., 40 Md. 595. See Brause v. New England Fire Ins. Co., 21 Wis. 509. A foreign corporation having no property of the debtor within the state, nor owing money to him payable within the state, cannot be garnisheed in the state. Wright v. Chicago, etc. R. R. Co., 19 Neb. 175.

³ Kansas and E. R. R. Cons. Co. v. Topeka, etc. R. R. Co., 135 Mass. 34.

provides that a foreign corporation may be sued on any cause of action by a resident of the state or a domestic corporation, but, when the plaintiff is a non-resident or a foreign corporation, only in the following cases: (1) when the action is brought to recover damages for the breach of a contract made within the state, or relating to property situated within the state at the time when the contract was made; (2) when the action is brought to recover real property situated within the state, or a chattel replevied within the state; (3) when the cause of action arose within the state, except where the object of the action is to affect the title to real property situated without the state. Before the passage of this, and other and former statutes which it supplements or is a substitute for, a foreign corporation could not be brought *in invitum* into a New York court.¹ But, even in cases where the statute does not confer jurisdiction, if the foreign corporation defendant appears voluntarily and pleads to the issue, the court will not decline jurisdiction.²

Under Michigan statutes, one foreign corporation may sue another in that state if the cause of action arose there, and both corporations are doing business there.³ In Massachusetts a non-resident may sue a foreign insurance company, which does business in that state, on a contract made in another state, where the subject-matter of the contract is also situated, although the only service made is on the insurance commissioner, whom all foreign insurance companies are required to appoint as their attorney for service of process.⁴

¹ See *Gibbs v. Queen Insurance Co.*, 63 N. Y. 114; and compare *Ervin v. Railway Co.*, 28 Hun (N. Y.), 269.

² *Root v. Great Western R'y Co.*, 65 Barb. 619; *aff'd* 55 N. Y. 636; *Downes v. Phoenix Bank*, 6 Hill (N. Y.), 297.

³ *Emerson, Talcott & Co. v. McCormick Harvesting Machine Co.*, 51 Mich. 5.

⁴ *Johnston v. Trade Ins. Co.*, 132 Mass. 432. (The insurance company had appointed the commissioner in accordance with the statute.) And see *Abell v. Penn Mutual Life Ins. Co.*, 18 W. Va. 400; *Desper v. Continental Water Meter Co.*, 137 Mass. 252. It is held, on the other hand, that a court will not take jurisdiction of an action for personal injuries caused by a foreign corporation in its own state, although the corporation operates a railroad in the state where the suit is brought. *Central R. R., etc. Co. v. Carr*, 76 Ala. 388.

Courts will not, however, determine controversies relating to the internal management of a foreign corporation, arising between one set of shareholders and persons claiming to be the officers, as well as shareholders, of the corporation.¹ But the legal relations between a corporation and its shareholders are to be determined by the law of the home state; and accordingly a state will recognize and apply a statute of the home state giving a corporation a lien on its shares for debts due to it from shareholders.²

§ 393. As a general rule, *penal* provisions will not be enforced outside of the jurisdiction of the state enacting them.³

Penal provisions not enforced outside the state enacting them. Statutory liability.

Some courts, however, will enforce the individual liability of the shareholders in an insolvent foreign corporation of a contractual nature arising under the statutes incorporating it, if the company does business within the state,⁴ or if the shareholders reside there.⁵ But a court will not enforce such liability when it can reach no corporate assets, and none of the shareholders reside within the state; although the corporation may have done business there.⁶ It is, however, held in Massachusetts that a

¹ Wilkins v. Thorne, 60 Md. 253; North State Copper, etc. Co. v. Field, 64 Md. 151.

² Bishop v. Globe Co., 135 Mass. 132.

³ See Story, Conflict of Laws, §§ 620, 621; Wharton's Conflict of Laws, § 833.

A statute of Indiana giving a right to recover a penalty for the failure of a telegraph company to transmit a message, has no extra-territorial force,¹ and therefore is not applicable to messages delivered to the company in another state to be sent to this state (Indiana). Carnahan v. Western Un. Tel. Co., 89 Ind. 526. But if the message is delivered to the telegraph company within the state, to be sent to a point without, the fact that the act of negligence preventing the message from

reaching its destination occurred outside of the state will not defeat a recovery. Western Un. Tel. Co. v. Hamilton, 50 Ind. 181. The determining circumstance, according to these two cases, is whether the contract with the telegraph company was entered into within the state.

⁴ Flash v. Conn., 16 Fla. 428; S. C. 109, U. S. 371.

⁵ Aultman's Appeal, 98 Pa. St. 505. *Semble* contra, Erickson v. Nesmith, 4 Allen, 233; see Same v. Same, 15 Gray 221. Compare Lowry v. Inman, 46 N. Y. 119.

⁶ Rice v. Hosier Co., 56 N. H. 114. The bill in this case was faultily drawn, the remedy under the foreign statute not being stated. See also Smith v. Mutual Life Ins. Co., 14 Allen, 336. A court of equity will

foreign corporation may maintain in the Massachusetts courts a bill against the officers of another foreign corporation, against which it holds a judgment obtained in the state where both corporations were organized, for discovery of the names of its stockholders and the number of shares held by each, when the officers of the debtor corporation reside in Massachusetts and its books are kept there, the ultimate object of the bill being to enable the plaintiff by a suit in its home state, to enforce the statutory liability of the stockholders of the debtor corporation.¹

§ 394. A court has no jurisdiction either to dissolve a foreign corporation,² or compel a distribution of its assets, even though its trustees are residents;³ or to enjoin the directors of such a corporation from paying a dividend, where no debt is due the plaintiff, and his ground of complaint is merely a supposed error on the part of the directors in declaring the dividend;⁴ or to appoint a receiver of a foreign corporation.⁵ But it has been held that a court (of chancery) has jurisdiction to wind up the affairs of an insolvent foreign corporation, doing business in the state, so far as to administer its assets within the jurisdiction of the court, and distribute them among the resident creditors.⁶

§ 395. In order that a judgment *in personam* against a foreign corporation shall be valid, so as to obtain recognition in other

not entertain a bill by a creditor to enforce the individual liability of shareholders of a foreign corporation, where the suit would entail an adjustment of many rights and the corporation would have to be a party. *Nimick v. Mingo Iron Works*, 25 W. Va. 184. Nor will a court entertain a bill by one foreign corporation against the shareholders of another foreign corporation, to compel them to pay the difference between the par value of their shares and what they paid for them. *New Haven Horse Nail Co. v. Linden Spring Co.*, 142 Mass. 349.

¹ *Post v. Toledo, etc. R. R. Co.*, 144 Mass. 341.

² *Dodge v. Pyrolusite Manganese Co.*, 69 Ga. 665.

³ *Redmond v. Enfield M'fg Co.*, 13 Abb. Pr. N. S. (N. Y.) 332. See *Wilkins v. Thorne*, 60 Md. 253; *North State Copper, etc. Co. v. Field*, 64 Md. 151.

⁴ *Howell v. Chicago, etc. R'y Co.*, 51 Barb. 378. But see *De Bemmer v. Drew*, 57 Barb. 438; *Prouty v. Mich. So., etc. R. R. Co.*, 1 Hun, 658.

⁵ *Stafford v. American Mills Co.*, 13 R. I. 310. See *Pierce v. Crompton*, ib. 312.

⁶ *Smith v. St. Louis Mut. Life Ins. Co.*, 6 Lea (Tenn.), 564. Compare *Paige v. Smith*, 99 Mass. 395.

states, it is prerequisite that the corporation should have appeared voluntarily,¹ or that a valid service of process should have been made within the jurisdiction of the court, upon an agent of the corporation representing it in the state. This rule has been recently expressed by the Federal Supreme Court, as follows:² "We are of opinion that when service is made within the state upon an agent of a foreign corporation, it is essential, in order to support the jurisdiction of the court to render a personal judgment that it should appear somewhere upon the record—either in the application for the writ, or accompanying its service, or in the pleadings or the findings of the court—that the corporation was engaged in business in the state. The transaction of business by the corporation in the state, general or special, appearing, a certificate of service by the proper officer on a person who is its agent there would, in our opinion, be sufficient *prima facie* evidence that the agent represented the company in the business. It would then be open, when the record is offered as evidence in another state, to show that the agent stood in no representative character to the company, that his duties were limited to those of a subordinate employé, or to a particular transaction, or that his agency had ceased when the matter in suit arose."³

¹ See *Attorney-General v. Guardian Mut. Life Ins. Co.*, 77 N. Y. 272.

² *St. Clair v. Cox*, 106 U. S. 350, 359, following the principles of *Pennoyer v. Neff*, 95 U. S. 714.

³ See also *Freeman v. Alderson*, 119 U. S. 185; *American Exp. Co. v. Conant*, 45 Mich. 642; *Lathrop v. Union Pac. R'y Co.*, 1 McArthur, 234; *Dallas v. Atlantic, etc. R. R. Co.*, 2 McArthur, 146; *Weight v. Liverpool, etc. Ins. Co.*, 30 La. Ann., Part II., 1186; *McNichol v. United States, etc. Agency*, 74 Mo. 457; *Weymouth v. Washington, etc. R. R. Co.*, 1 McArthur, 19; *Georgia Southern R. R. Co. v. Bigelow*, 68 Ga. 219; *Moore v. Wayne Circuit Judge*, 55 Mich. 84. A foreign cor-

poration has a residence in a county where it has an office or agent for transacting business. *Harding v. Chicago, etc. R. R. Co.*, 80 Mo. 659.

An Illinois statute required foreign insurance companies doing business in that state, to appoint in writing a resident attorney on whom process could be served. The insured took out a policy in Michigan, died, and an Illinois court appointed an administrator, the policy of insurance being the only assets. *Held*, the administrator could sue the Insurance Co. in Illinois. "In view of this legislation and the policy embodied in it, when this corporation, not organized under the laws of Illinois, has, by virtue of those laws, a place of business in Illinois, and a

§ 396. It thus appears that, in order to bind the corporation by the judgment, the person on whom service is made must be the agent of the corporation representing it *there* within the state whose process is served on him. And the agents of a corporation are not its representatives for the purpose of receiving service of process in a state where the corporation transacts no business.¹ When a foreign corporation has a regular office for the transaction of business within a state, service on the head officer of such office will be a valid service on the corporation in respect of causes of action arising within the jurisdiction;² but not in respect of causes arising outside of the jurisdiction of the court whose process is served on the resident agent.³

general agent there, and a resident attorney there for the service of process, and can be compelled to pay its debts there by judicial process, and has issued a policy payable on death, to an administrator, the corporation must be regarded as having a domicile there, in the sense of the rule that the debt on the policy is assets at its domicile, so as to uphold the grant of letters of administration there." *New England Mut. Life Ins. Co. v. Woodworth*, 111 U. S. 138, 145.

¹ *McQueen v. Middleton M'fg Co.*, 16 Johns. (N. Y.) 5, 7; *Peckham v. North Parish*, 16 Pick. 274, 286; *Newell v. Great Western R'y Co.*, 19 Mich. 336; *Latimer v. Union Pac. R'y Co.*, 43 Mo. 105; *Moulin v. Ins. Co.*, 24 N. J. L. 222; *Camden Rolling Mill Co. v. Swede Iron Co.*, 32 N. J. L. 15; *State v. District Court*, 26 Minn. 233, 234.

² *Newsby v. Colt's Patent Fire Arms Co.*, L. R. 7 Q. B. 293; *City Fire Ins. Co. v. Carrugi*, 41 Ga. 66, 671; *Western Un.Tel. Co. v. Pleasants*, 46 Ala. 641; *Atlantic and G. R. R. Co. v. Jacksonville P. and M. R. R.*

Co., 51 Ga. 458; see *Libbey v. Hodgdon*, 9 N. H. 394.

³ *Bawknight v. Liverpool, etc. Ins. Co.*, 55 Ga. 194; see *National Condensed Milk Co. v. Brandenburg*, 40 N. J. L. 111; *Parke v. Commonwealth Ins. Co.*, 44 Pa. St. 422. A verified answer that defendant is a corporation created by the laws of another state, and not by the laws of the state where suit is brought; that the person upon whom process was served was its agent only in the county where the action was commenced, and that the contract sued on was made out of the state; and not by the agent served, and was not connected with the business of his office, is good on demurrer to abate the action for want of jurisdiction of the person of the defendant. *Ætna Ins. Co. v. Black*, 80 Ind. 513. But when the subject-matter of the suit is one over which the court has jurisdiction, and the defendant, a foreign corporation, appears and goes to trial on the merits, without objection, it cannot except to the jurisdiction of the court over it. *North Missouri R. R. Co. v. Akers*, 4 Kan. 453.

§ 397. It is customary, however, for state legislatures by statute to designate the persons on whom service shall or may be made in actions against foreign corporations. Service in accordance with the statute will be valid, at least within the jurisdiction of the state; for by coming within the state to do business, a foreign corporation submits itself to the state laws; and it may thus submit itself expressly by filing a certificate pursuant to the statute designating an agent on whom service may be made.¹

§ 398. In New York it is held that when a foreign corporation has done business in that state, and suit is brought on a cause of action arising there, service on one of its directors temporarily in the state on his own business is a valid service on the corporation; and this, on the ground that "any service must be deemed sufficient which renders it reasonably probable that the party proceeded against will be apprised of what is going on against him, and have an opportunity to defend."² A recent case in New York certainly goes very far in upholding the validity of service on a foreign corporation. Section 1780 of the New York Code of Civil Procedure provides that "an action against a foreign corporation may be maintained by a resident of the state, or by a domestic corporation, for any cause of action." Section 432 provides that personal service of the summons upon a foreign corporation may be made by delivering a copy within the state to the president, secretary, or treasurer. In the case referred to, *Pope v. Terre Haute Car Manufacturing Company*,³ it appeared that a foreign corporation had transacted no business within the state, and had neither property nor a place of business there. The plaintiffs were residents, and the cause of action arose on contract. The summons was served on the defendant's president while he was temporarily within the state on his way to a seaside resort, and not in his official capacity

¹ See *Lafayette Ins. Co. v. French*, 18 How. 404; *Gibbs v. Queen Ins. Co.*, 63 N. Y. 114; *Warren M'fg Co. v. Aetna Ins. Co.*, 2 Paine, 501; *Benwood Iron Works v. Hutchinson*, 101 Pa. St. 359.

² *Hiller v. Burlington, etc. R. R. Co.*, 70 N. Y. 223. See also *Gibbs v. Queen Ins. Co.*, 63 N. Y. 114; *Lafayette Ins. Co. v. French*, 18 How. 404, 407. See § 392.

³ 87 N. Y. 137.

nor on any business connected with the corporation. The court held the service sufficient, and that a judgment rendered in the action would be valid for every purpose within the state, and could be enforced against any corporate property within the state at any time. "The object," said the court, "of all service of process for the commencement of a suit or any other legal proceeding is to give notice to the party proceeded against, and any service which reasonably accomplishes that end answers the requirements of natural justice and fundamental law; and what service shall be deemed sufficient for that purpose is to be determined by the legislative power of the country in which the proceeding is instituted, subject only to the limitation that the service must be such as may reasonably be expected to give the notice aimed at." The court said they did not determine what would have been the effect outside the state of the judgment rendered upon such service, and from the authorities heretofore cited and the principles heretofore stated, it would seem such a service and a judgment rendered thereon would have no validity whatsoever or be recognized in the courts of any other state.¹ A judgment, however, rendered in a suit in which the foreign corporation is brought within the jurisdiction of the court, must under the Federal constitution be recognized in all the states.²

§ 399. Finally, although the defendant foreign corporation is not brought within the jurisdiction of the court, a valid judgment *in rem* may be entered against any property attached within the state.³ But no valid personal judgment against the corporation could be rendered in an action commenced in this way.⁴

§ 400. In a number of the states exist statutes prescribing the terms upon which foreign corporations shall be permitted to do business. These terms ordinarily are that a corporation before commencing business shall file a certificate in the prescribed public office, design-

Proceed-
ings *in rem*.

Statutes
imposing
terms on
foreign cor-
porations.

¹ See *Branson v. Trump Bros. Machine Co.*, 16 Phila. (Pa.) 112.

² *Lafayette Ins. Co. v. French*, 18 How. 404.

³ *Bushel v. Commonwealth Ins Co.*, 15 S. & R. 174; see *Warren Mfg*

Co. v. Ætna Ins. Co., 2 Paine, 501; *Latimer v. Union Pac. R'y Co.*, 43 Mo. 105; *Barnett v. Chicago, etc. R. Co.*, 4 Hun, 114.

⁴ *St. Clair v. Cox*, 106 U. S. 350.

nating the principal place of business of the corporation within the state and a resident agent on whom process may be served.¹ Some states have attempted to impose the further condition that no suit against the corporation brought by a resident of the state shall be removed into the Federal courts. But this is unconstitutional. A state may exclude foreign corporations entirely; but if she admits them to do business within her limits, she cannot impose on them conditions repugnant to the Federal constitution.² So a state statute which declares that every foreign insurance company before transacting business in the state shall agree not to remove any case into the Federal

¹ By soliciting and receiving subscriptions for a newspaper published by it in another state, a foreign corporation is not doing business in Alabama within the meaning of the section of the Alabama constitution, which prohibits foreign corporations from doing any business in the state without having at least one known place of business and an authorized agent therein. *Beard v. The Union, etc. Publishing Co.*, 71 Ala. 60.

The doing of a single act of business within the state does not bring a corporation within the operation of the Colorado statute. *Cooper M'fg Co. v. Ferguson*, 118 U. S. 727. Compare *Hacheny v. Leary*, 12 Oregon, 40.

Where the complaint of a foreign corporation is silent on the subject, the court will presume on demurrer that the statute requirements enabling it to do business in the state have been complied with. *Sprague v. Cutler, etc. Co.*, 106 Ind. 242; *Cassaday v. American Ins. Co.*, 72 Ind. 95.

A decree and sale on foreclosure by a foreign corporation (which became the purchaser at the sale), is not invalidated by the fact that its agent had not filed a power of attorney, as re-

quired by statute. This should have been pleaded in abatement in the foreclosure suit. *Elston v. Pigott*, 93 Ind. 14.

² *Lafayette Ins. Co. v. French*, 18 How. 404. Amendment XIV. to the Federal constitution, which forbids a state to deny to any person the equal protection of its laws, does not apply to conditions imposed on foreign corporations on entering the state; though it may apply to such corporations after they have performed the conditions entitling them to come in. *People v. Fire Ass'n*, 92 N. Y. 311; affirmed *Philadelphia Fire Ass'n v. New York*, 119 U. S. 110. See *Phoenix Ins. Co. v. Welch*, 29 Kans. 672, §§ 479-481.

A state legislature may lay a franchise or license tax on foreign corporations for the privilege of doing business within the state. *Commonwealth v. Standard Oil Co.*, 101 Pa. St. 119.

It is held, moreover, that a person may waive a constitutional provision in his favor. *Embury v. Conner*, 3 N. Y. 511; *Sherman v. McKeon*, 38 N. Y. 266; *Vose v. Cockcroft*, 44 N. Y. 415; *Phyfe v. Eimer*, 45 N. Y. 103; *Matter of the Application of Cooper*, 93 N. Y. 507.

courts, is unconstitutional; and an agreement filed in pursuance thereof derives no support therefrom and is void.¹

§ 401. In regard to the effect of non-compliance with these statutes the decisions of the different states are not harmonious. In Colorado, where the statute provides that foreign corporations *shall* file a certificate designating the principal place of business where the business within the state is to be carried on,² before "they are authorized or permitted to do any business in the state," a corporation that has not complied with the statute may still sue for a trespass.³ In Indiana it is held that a note executed there to a foreign insurance company is not void because the company has not complied with the statute, but that the remedy on the note is suspended until compliance.⁴ In Illinois, however, contracts entered into before compliance cannot be enforced.⁵ And in Oregon a mortgage taken by a foreign corporation before compliance is void, at least as to all persons other than the mortgagor, having an interest or liens on the premises.⁶ Construing this Oregon statute Judge Deady of the Federal Circuit Court, has rendered the most extreme decision of all on this subject. He held that land foreclosed under a mortgage

Effect of non-compliance with these statutes.

¹ Insurance Co. v. Morse, 20 Wall. 445; Doyle v. Continental Ins. Co., 94 U. S. 535; reversing State v. Döyle, 40 Wis. 175; Barron v. Burnside, 121 U. S. 186. Compare Home Ins. Co. v. Davis, 29 Mich. 238; and see Railway Co. v. Whitton, 13 Wall. 270; Elston v. Piggott, 93 Ind. 14.

² A certificate signed and acknowledged by the president and secretary of a foreign corporation, and filed with the secretary of state and in the office of the recorder of deeds for the county in which it is proposed to carry on business, stating that "the principal place where the business shall be carried on in the state of Colorado shall be at Denver, in the county of Arapahoe, in said state, and that the general manager of said corporation, residing

at the said principal place of business, is the agent upon whom process may be served in all suits that may be commenced against said corporation," is a sufficient compliance with the constitution and laws of Colorado. Goodwin v. Colorado Mortgage Co., 110 U. S. 1.

³ Utley v. Clark-Gardner M'g Co., 4 Col. 369.

⁴ American Ins. Co. v. Wellman, 69 Ind. 413; Lamb v. Lamb, 13 Bankr. Reg. 17. Compare Union Ins. Co. v. Smart, 60 N. H. 458.

⁵ Cincinnati Mut. Health Assurance Co. v. Rosenthal, 55 Ill. 85.

⁶ Bank of British Columbia v. Page, 6 Oreg. 431. See *In re Comstock*, 3 Sawyer, 218; S. C., 11 Bankr. Reg. 169.

made to a foreign corporation, and bought in by it, might be recovered back by the mortgagor, on the ground that the corporation had not complied with the statute.¹

§ 402. A foreign corporation may not itself take advantage of its own non-compliance with one of these statutes; suit may be brought against it notwithstanding.²

When a foreign corporation has complied with the prescribed conditions, it acquires most of the ordinary privileges of domestic corporations, and for instance, may plead the statute of limitations like a domestic corporation or resident citizen.³ It does not follow, however, that a foreign corporation will be entitled to plead the statute of limitations merely because it has continuously through its agents done business in the state.⁴

Statute of
limita-
tions.

2. STATUS OF A BODY OF MEN INCORPORATED BY THE LEGISLATION OF TWO OR MORE STATES.

One or two corporations? §§ 403-408. | Jurisdiction of courts of either state.
Meetings, § 409.

§ 403. Perplexing questions have arisen and seem likely to arise in regard to corporations incorporated or consolidated by the concurrent legislation of more than one state; and, it is submitted, these questions can

One or two
corpora-
tions?

¹ *Simple v. Bank of British Columbia*, 5 Sawyer, 88. It is impossible to agree with a decision sustaining this dishonest defence. The Wisconsin court, more in conformity to the view that debtors should pay their just debts, holds that a foreign insurance corporation which has not complied with the statute prescribing conditions on which it may do business in the state, may still take mortgage security for a debt due there and enforce it in the courts of the state. *Charter Oak Life Ins. Co. v. Sawyer*, 44 Wis. 387.

² *Hagerman v. Empire State Co.*, 97 Pa. St. 534.

³ *Huss v. Central R. R., etc. Co.*, 66 Ala. 472. Compare *Barr v. King*, 96 Pa. St. 485.

⁴ *Hubbard v. United States Mortgage Co.*, 14 Ill. App. 40; *Mallory v. Tioga R. R. Co.*, 3 Abb. Dec. (N. Y.) 139. But in Montana where a foreign corporation has owned property and openly maintained a place of business with a managing agent, in the state, a personal judgment can be rendered against it, and it can plead the statute of limitations, though it has failed to comply with the Montana statute, by filing its charter; such failure merely relieving any party suing the corporation from proving its incorporation, except by reputation. (The statute is express herein.) *King v. National M. T. E. Co.*, 4 Montana, 1.

be properly solved only by applying the analysis of the idea of a corporation given above in Chapter III. The two entirely different notions conveyed by the term corporation must be borne in mind; the one, a body of men; the other, a legal institution or group of laws relating to the corporate enterprise in their manifestation in legal relations. Perhaps the fundamental question in regard to incorporation by the concurrent legislation of two states, is whether, and in what respects, there results one or two corporations. It is plain, using the term corporation to denote a body of men, that there is but one corporation; for evidently there is but one body of shareholders who meet and vote; and this body is the same whether acting in the one state or the other.

§ 404. But is there one or are there two legal institutions? *i. e.*, one or two groups of laws which have manifested themselves in legal relations. A law has no force beyond the limits of the state enacting it. A legal right is the power which a person has through the aid of a law to compel another to do or forbear; and, as before pointed out, a legal right with its corresponding liability constitutes a legal relation; which is the manifestation of a rule of law in operation.¹ It is consequently evident that the identical legal relation cannot subsist in two states, except in so far as it is the manifestation of a law operating in both; *i. e.*, the manifestation of a law of Congress or a provision in the Federal constitution. In so far as a person has a right which is the manifestation of a constitutional provision, or of a law of Congress competently enacted, the identity of the right is not affected by the fact of its possessor being in New York or New Jersey.²

§ 405. To illustrate, suppose New York and New Jersey to incorporate a railroad corporation by precisely similar legisla-

¹ Chap. III.

² Accordingly, a corporation created by act of congress and doing business in Pennsylvania is not a "foreign corporation" under the Pennsylvania statutes which provide for the taxation of foreign corporations. *Commonwealth v. Texas, etc. R. R. Co.*, 98

Pa. St. 90. See *Eby v. Northern Pac. R. R. Co.*, 13 Phila. 144, which holds that a corporation created by act of congress may be sued anywhere in Pennsylvania where proper service of process can be made; as the corporation exists in Pennsylvania.

tion ; each state enacting among other provisions that the shareholders shall be individually liable for debts due the employes of the company. Suppose A. to be an employé, and B. a shareholder. In New Jersey A.'s right against B. depends on the New Jersey enactment backed by the physical power of the New Jersey government ; and in New York A.'s right against B. depends on the New York enactment. A.'s right in New York is the manifestation of a law different from the law which manifests itself in A.'s right in New Jersey ; and would be enforced by a different set of courts, whose decrees in their turn would be enforced by different physical backings. However, a right of A. against B. having once vested in respect of a debt due from the corporation, neither state can pass a law depriving A. of his right ; for such an enactment would be void under the Federal constitution, as impairing the obligation of a contract. This further guaranty of A.'s right, that he shall not be deprived of it, is not the manifestation of a state law ; but of a rule of law contained in the Federal constitution, and thus operating in both states ; and would in the last resort be enforced in either state by the same power. Consequently, this further right of A. is identical in both states.

Accordingly, it may be said, that the legal relations subsisting in respect of any corporate enterprise, which extends throughout two or more states, in so far as in each state they are manifestations of different groups of laws, are different groups of legal relations, and constitute not identical, though perhaps precisely similar legal institutions. Thus there may be said to be two corporations.¹

§ 406. Justice Breese said, giving the opinion of the Supreme Court of Illinois in *Quincy Bridge Company v. Adams County*,² "But, it is said, by the appellants, this corporation, although

¹ The same body of persons can, by accepting charters from two states, become "constituted into two distinct corporate entities in the two states, acting in each according to the powers locally bestowed, as distinctly as though they had nothing in common, either as to name, capital, or membership." 162.

Clark v. Barnard, 108 U. S. 436. Yet

the Supreme Court has said in a later case that when a corporation is chartered under the same name by several states, it has but one set of shareholders, and each shareholder is interested in all its property. *Graham v. Boston, etc. R. R. Co.*, 118 U. S.

² 88 Ill. 615, 619.

it derived some of its powers, and in part its corporate existence from this state, derived an equal part from the sovereign state of Missouri, and therefore they are not a corporation created under the laws of either state. To this it is answered, and we think satisfactorily, that the legislatures of this state and of Missouri cannot act jointly, nor can any legislation of the last named state have the least effect in creating a corporation in this state. Hence, the corporate existence of appellants considered as a corporation of this state must spring from the legislation of this state, which, by its own vigor, performs the act. The states of Illinois and Missouri have no power to unite in passing any legislative act. It is impossible in the very nature of their organization that they can do so. They cannot so fuse themselves into a single sovereignty, and as such create a body politic which shall be a corporation of the two states, without being a corporation of each state or of either state. As argued by appellee, the only possible *status* of a company acting under charters from two states is that it is an association incorporated in and by each of the states, and when acting as a corporation in either of the states, it acts under the authority of the charter of the state in which it is then acting, and that only; the legislation of the other state having no operation beyond its territorial limits.”¹

Speaking with reference to the consolidation of corporations organized under the laws of different states, Judge Cooley said in a recent Michigan case:—

“It is familiar law that each corporation has its existence and domicile, so far as the term can be applied to the artificial person, within the territory of the sovereignty creating it; it comes into existence there by an exercise of the sovereign will; and though it may be allowed to exercise corporate func-

¹ See also *State v. Northern Central Ry. Co.*, 18 Md. 193, 213; *Farnum v. Blackstone Canal Co.*, 1 Sumner, 47; *Port Royal R. R. Co. v. Hammond*, 58 Ga. 523; *County of Allegheny v. Cleveland, etc. R. R. Co.*, 51 Pa. St. 228. In *Covington Bridge Co. v. Mayer*, 31 Ohio St. 317, 325, it was said that a corporation created by two states receiving similar charters from both “is a single corporation clothed with the powers of two corporations. It acts under two charters, which, in all respects, are identical, except as to the source from which they emanate.”

tions within another sovereignty, it is impossible to conceive of one joint act, performed simultaneously by two sovereign states, which shall bring a single corporation into being, except it be by compact or treaty. There may be separate consents given for the consolidation of corporations, separately created; but when the two unite they severally bring to the new entity the powers and privileges already possessed, and the consolidated company simply exercises in each jurisdiction the powers the corporation there chartered has possessed,¹ and succeeds there to its privileges. It may well happen, as indeed it often has, that the consolidated company will be a corporation possessing in one state very different rights, powers, privileges, and immunities to those possessed in another, and subject to very different liabilities. And after the consolidation each state legislates in respect to the road within its own limits, and which was constructed under its grant of corporate power, the same as it did before. And it cannot follow the new organization with its legislation into another state. It has been said that the consolidated company exists in each state under the laws of that state alone; and this is the effect of the decision in Delaware Railroad Tax, 18 Wall. 206, and in many other cases. It also follows necessarily from the doctrine maintained by the Federal Supreme Court in respect to the citizenship of corporations. That doctrine is that a corporation is deemed to be a citizen of the state which has created it, and an organization of members who are citizens of that state. When, therefore, two corporations created in different states consolidate, though for most purposes they are not therefore to be separately regarded, yet in each state the consolidated company is deemed to stand in the place of the corporation to which it there succeeded, and of its members, and consequently to be a citizen of that state for many purposes, while in the other state it would stand in the place of the other corporations in respect to citizenship there.”²

¹ How about inter-state comity?

² Chicago and N. W. Ry. Co. v. Auditor-General, 53 Mich. 79, 92. Opinion of the court per Cooley, C. J., citing many cases.

The contracts of such a corporation

will be construed “as if made by the corporation of each state in which the subject-matter lies; *ut res magis valeat quam pereat*.” *Racine, etc. R. Co. v. Farmers’ Loan, etc. Co.*, 49 Ill. 331, 352.

§ 407. Still, perhaps, the question whether there is one or two corporations may be regarded as mainly one of definition. Thus, if we define a corporation, meaning a legal institution, as the sum of the legal relations subsisting in respect of a given corporate enterprise, it may be said that this sum includes all the legal relations whether they be the manifestations of the laws of New York or of New Jersey. But the sum of all these legal relations cannot subsist in either state; part of them subsisting in one and part in the other; though the two parts may be so precisely similar that for most purposes they can be regarded as identical. And thus, though there may be said to be but one corporation, it does not subsist in its sum total in either state.¹ On the other hand, the group of legal relations subsisting in either state may there, if the courts so choose, be regarded as the corporation, without reference to the group of legal relations which subsist in respect of the same corporate enterprise in the other state. And viewing the matter in this way, there may be said to be two groups of legal relations, *i. e.*, two legal institutions or corporations.²

§ 408. The preceding remarks seem to accord with the decisions of the Federal Supreme Court. For instance, in *Ohio and Mississippi Railroad Co. v. Wheeler*,³ it was held that there could not be a corporation endowed with corporate capacities by the co-operating legislation of two states, so as to be one and the same legal being in both; for a corporation has no legal existence in a state except by the laws of that state. No state can confer corporate existence in another. In accordance with

¹ In *Newport and Cincinnati Bridge Co. v. Woolley*, 78 Ky. 523, it was held two states could not by partial legislation create a corporation which should have a complete legal existence in either. A corporation cannot have two domiciles. But see § 409.

² See *Clark v. Barnard*, 108 U. S. 436, and compare *Heuen v. Baltimore, etc. R. R. Co.*, 17 W. Va. 881.

"It is true that the Erie Railway Company is a foreign corporation, yet at the same time it is domestic to the

full extent of the powers and franchises conferred and invested in it here in New Jersey. A corporation may have a twofold organization, and be, so far as its relations to our state is concerned, both foreign and domestic. It may have a corporate entity in each state, yet in its general character be of a bifold organization." *McGregor, qui tam, v. Erie R'y Co.*, 35 N. J. L. 115, 118. Opinion of court per Bedle, J.

³ 1 Black, 286.

this, a court in either state would limit the range of its legal vision to the group of legal relations subsisting there. To be sure, in *Railroad Co. v. Harris*,¹ Justice Swayne said, giving the opinion of the court: "We see no reason why several states cannot by competent legislation unite in creating the same corporation, or in combining several pre-existing corporations into one."² It does not necessarily follow, however, that the whole of such a corporation would exist in any one state. But viewing the corporation in this light, a court would extend its vision to the legal relations subsisting in all the states through which the corporate enterprise might extend. The point which the court in *Railroad Company v. Harris* actually decided, was that a railroad corporation chartered by several states and by Congress as well, was amenable to the courts of the District of Columbia for personal injuries received on its road in Virginia. In a later case the Supreme Court held that although one corporation be consolidated with another incorporated by a different state, still in its own state it exists under the laws thereof.³

§ 409. Corporations owing part of their corporate existence to a state, and exercising their franchises within its

Jurisdiction of
courts of
either state.
Meetings.

limits, may be there restrained from expending their funds for other than corporate purposes anywhere.⁴

But a state court of chancery has no jurisdiction to compel a domestic corporation to go into another state, from

¹ 12 Wall. 65, 82; perhaps modifying the language of the court in *Ohio and Miss. R. R. Co. v. Wheeler*. But see the latest expression of the Federal Supreme Court, in note to § 405.

² *Acc. Bishop v. Brainard*, 28 Conn. 289.

³ *Muller v. Dows*, 94 U. S. 444; *Acc. Railway Co. v. Whitton*, 13 Wall. 270. See §§ 411, 412.

A charter granted by two states to a corporation is not only a compact with it, but also a contract between the two states; and the same construction must be put on it by both. *Cleveland and Pittsburgh R. R. Co. v. Speer*, 56 Pa. St. 325; *Brockett v. Ohio*, etc.

R. R. Co., 14 Pa. St. 241, 244. But art. 1, sec. 10 of the Federal Constitution forbids compacts between states; hence quære?

⁴ *State v. Northern Central R'y Co.*, 18 Md. 193, 213. See *Wilmer v. Atlanta, etc. R'y Co.*, 2 Woods, 409; *Fisk v. Chicago, etc. R. R. Co.*, 53 Barb. 513. A Connecticut court has jurisdiction to foreclose a mortgage made by a consolidated corporation created by New York and Connecticut, although part of the mortgaged property lies in New York. *Mead v. New York H. and N. R. R. Co.*, 45 Conn. 199.

which it may also have received a charter, and there specifically execute a contract, by opening ditches on the complainant's land, and keeping them open to a certain depth; and on its failure thus to perform, to enforce the decree by attachment and sequestration of its property in the former state.¹ A corporation created by charters from two states may competently hold shareholders' meetings in either;² and a meeting held in one of the states is valid with respect to all the property of the corporation wherever situated. Such a corporation has a domicile in each state.³

3. CITIZENSHIP OF CORPORATIONS WITH RESPECT TO THE JURISDICTION OF THE FEDERAL COURTS.

Earlier rule, § 410.

Overruled, §§ 411, 412.

Averments in pleading, § 413.

§ 410. The questions just discussed regarding the *status* of a corporation incorporated by two states have, in large measure, arisen with respect to that jurisdiction of the Federal courts which depends on the citizenship of the parties to a suit.⁴ The earliest case in the Supreme Court on this jurisdiction, when a corporation is a party, is

Earlier rule.

¹ Port Royal R. R. Co. v. Hammond, 58 Ga. 523. See Eaton, etc. R. R. Co. v. Hunt, 20 Ind. 457; Hart v. Boston, H. and E. R. R. Co., 40 Conn. 524.

² Covington Bridge Co. v. Mayer, 31 Ohio St. 319; Graham v. Boston, etc. R. Co., 14 Fed. Rep. 753.

³ Graham v. Boston, etc. R. R. Co., 118 U. S. 162. But authority from a state to a foreign railroad corporation to extend its road into such state, does not make the corporation a corporation of that state; unless the language of the statute implies the creation of a corporation. Pennsylvania R. R. Co. v. St. Louis, etc. R. R. Co., 118 U. S. 290; Goodlett v. Louisville, etc. R. R., 122 U. S. 391. This is a ques-

tion of legislative intent; *i. e.*, did the state mean the foreign corporation to become a domestic corporation? Angier v. East Tennessee, etc. R. R., 74 Ga. 634. Franchises granted by a state to a foreign corporation will not make it a domestic corporation, where it does not accept the franchises or act under them. Philadelphia W. & B. R. R. Co. v. Kent County R. R. Co., 5 Houst. (Del.) 127.

⁴ A corporation may be entitled on other grounds to sue in a Federal court. See Fed. Cons., Art. III. § 2. Compare Miners' Bank v. Iowa, 12 How. 1. A national bank can, by reason of its character as such, sue in a Federal court. Bank of Omaha v. Douglas County, 3 Dill. 298.

Bank of United States v. Deveaux,¹ which held that, though a corporation aggregate composed of citizens of one state might sue a citizen of another state in a Federal Circuit Court, yet such a corporation could not in its corporate capacity be a citizen of the state incorporating it so as to be competent to sue in a Federal Circuit Court without regard to the citizenship of its members.²

§ 411. This case was overruled in *Louisville, Cincinnati, etc. R. R. Co. v. Letson*,³ where the court said that a corporation created by a state to perform its functions under the authority of that state, and only suable there, though it may have members out of the state, seemed to them a person, though an artificial one, inhabiting and belonging to that state, and therefore entitled, for the purpose of suing and being sued, to be deemed a citizen thereof. It was accordingly held, that a citizen of one state could sue a corporation created by another in the Federal Circuit Court for the latter state, although some of the members were not citizens of the state where the suit was brought, and the state itself was a member of the corporation.

The last case was followed, after some years, by *Railway Co. v. Whitton*,⁴ where the court again held that, although a corporation, being an artificial body created by legislation, was not a citizen within the meaning of several provisions of the constitution, still where rights of action were to be enforced, it would be regarded as a citizen of the state where it was created, within the meaning of the clause extending the judicial power of the United States to controversies between citizens of different states.

§ 412. *Railway Co. v. Whitton* was affirmed in *Muller v. Dows*,⁵ though the reasoning of the court was somewhat modified in the latter case; where it was said that a corporation could not itself be a citizen of a state in the sense in which the word "citizen" is used in the Federal constitution. But they

¹ 5 Cranch, 61.

² *Accord Commercial, etc. Bank v. Slocomb*, 14 Pet. 60; *Irvine v. Lowry*, 14 Pet. 293.

³ 2 How. 497. This was the first

case in the Supreme Court reports where a railroad corporation was a party.

⁴ 13 Wall. 270.

⁵ 94 U. S. 444.

held that a suit might be brought in a Federal court by or against a corporation, and that in such a case the suit would be regarded as if brought by or against the shareholders, all of whom for jurisdictional purposes would be conclusively presumed to be citizens of the state incorporating the corporation.¹ The plaintiff in *Muller v. Dows* was a resident of Missouri, and sued the corporation in the United States Circuit Court for Iowa. The corporation was incorporated by both Missouri and Iowa; and it was held that as to suits brought in Iowa the Missouri corporation could not be regarded, and the Circuit Court for Iowa had jurisdiction of the suit.² On similar principles, applied under reversed circumstances, it was held in *Ohio and Mississippi R. R. Co. v. Wheeler*,³ that a corporation created by Ohio and Indiana could not sue a citizen of Indiana in a United States Circuit Court for the district of Indiana.

¹ See *Steamship Co. v. Tugman*, 106 U. S. 118; *Maltz v. American Exp. Co.*, 1 Flap. 611. Under § 11 of the judiciary act of 1789, a corporation cannot be made a party defendant to a civil suit in a Federal Circuit or District Court by original process, in any other district than a district of the state by which it was created. *Myers v. Dorr*, 13 Blatchf. 22. A corporation by doing business in a state as permitted by the laws thereof, having a resident agent, etc., does not become a citizen of that state for the purposes of Federal jurisdiction. *Insurance Co. v. Francis*, 11 Wall. 210. See *Brownell v. Troy, etc. R. R. Co.*, 18 Blatchf. 243; *Callahan v. Louisville, etc. R. Co.*, 11 Fed. Rep. 536; *Guinn v. Iowa Cent. Ry. Co.*, 14 Fed. Rep. 323. But see *Balto. and Ohio R. R. Co. v. Wightman's Adm'r*, 29 Gratt. (Va.) 431; *Same v. Noell's Adm'r*, 32 Gratt. 394; *Stout v. Sioux City, etc. R. R. Co.*, 3 McCrary, 1; *N. Y. and Erie R. R. Co. v. Shepard*, 5

McLean, 455. For instance, a railroad corporation created by Maryland does not become a citizen of Virginia by taking a lease of a Virginia railroad and can still remove to the Federal court a suit brought against it by a citizen of Virginia. *Railroad Co. v. Koontz*, 104 U. S. 5.

Where by the local law a foreign corporation is amenable to suit in the courts of the state, service being made upon an agent within the state, the Federal courts may be regarded as courts of the state, and may take jurisdiction on a service that would be good in a state court. *Ex parte Schollenberger*, 96 U. S. 369; *Eaton v. St. Louis, etc. M'g Co.*, 2 McCrary, 362.

² See § 408. Also, *Marshall v. Baltimore, etc. R. R. Co.*, 16 How. 314.

³ 1 Black. 286, § 408; *Accord*, *Memphis, etc. R. R. Co. v. Alabama*, 107 U. S. 581; *County of Allegheny v. Cleveland, etc. R. R. Co.*, 51 Pa. St. 228. Compare *Railroad Co. v. Harris*, 12 Wall. 65.

§ 413. In order to give jurisdiction to the Federal court, it should appear by the pleadings that the corporation was incorporated by a state other than that of which the other party is a citizen.¹ An averment that a drawbridge company were citizens of Indiana is sufficient to give jurisdiction to a Federal Circuit Court, the company having been incorporated by a public statute, of which the court is bound judicially to take notice.² Likewise, that the defendant "is a foreign corporation formed under and created by the laws of the state of New York," is a sufficient averment of citizenship.³ But in a suit brought against a corporation by a state, an averment that the defendant is "a body politic in the law of and doing business in" another state is insufficient to give jurisdiction to the Federal Supreme Court.⁴ An averment that the defendant is a "corporation created by an act of the legislature of New York, located in Aberdeen, Mississippi, and doing business under the laws of the state," is no averment that the defendant is a citizen of *Mississippi*.⁵

¹ *Mansfield C. and L. M. Ry. Co. v. Swan*, 111 U. S. 379; *Muller v. Dows*, 94 U. S. 444. See *Marshall v. Baltimore, etc. R. R. Co.*, 16 How. 314. Compare *N. Y. and Erie R. R. Co. v. Shepard*, 5 McLean, 455. A corporation created by a territorial legislature is, after the territory becomes a state, a citizen of that state within the clause defining the jurisdiction of the Federal courts. *Kansas Pacific R. R. Co. v. Atchison T. and S. F. R. R. Co.*, 112 U. S. 414.

Corporations created by congress can remove cases to the Federal courts on the ground that the suits against them are suits "arising under the laws of the United States." *Pacific R. R. Removal Cases*, 115 U. S. 2.

² *Covington Drawbridge Co. v. Shepherd*, 20 How. 227. But see *Lafayette Ins. Co. v. French*, 18 How. 404.

³ *Express Co. v. Kountze Brothers*, 8 Wall. 342.

⁴ *Pennsylvania v. Quicksilver Co.*, 10 Wall. 553.

⁵ *Insurance Co. v. Francis*, 11 Wall. 210; *N. Y. and Erie R. R. Co. v. Shepard*, 5 McLean, 455, seems at variance with this case. See § 412.

Under the act of March 3, 1875, to entitle a party to remove a suit, his citizenship relied on must have existed when the suit was begun and also when the petition for removal was filed. *Houston and T. C. Ry. Co. v. Shirley*, 111 U. S. 358.

4. SUCCESSION.

Succession; consolidation; dissolution, § 414.	Property passes subject to restrictions, § 416.
Succession, wherein differing from consolidation, § 415.	Successor assumes position of former corporation, § 417
	Special exemptions may not pass, § 418.

§ 414. There are certain transactions or proceedings by which the legal relations subsisting in respect of a corporate enterprise are affected radically or even as a whole; the first, a sort of succession, where the rights, franchises, and property of a corporation are acquired by an individual or by another corporation;¹ the second, a consolidation, where two or more corporations are united; the third, a dissolution, where a final liquidation of the legal relations subsisting in respect of a corporate enterprise takes place. The three proceedings have much in common, indeed run into each other. A consolidation rarely occurs without a succession as well as a dissolution. Succession, the simplest of these proceedings, may be considered first.²

§ 415. What is here called a succession takes place when the property and franchises of a corporation are bought, for instance on the foreclosure of a mortgage.³ A succession differs from a consolidation in this respect, among others, that the purchaser acquiring the property and franchises of the corporation, does not become responsible for its liabilities already accrued;⁴ while, on the other

¹ For the rights of creditors when the property of an insolvent corporation is transferred, say to another corporation composed of the same shareholders, see §§ 657, 667, 708.

² For the power of a corporation to transfer its franchises, see §§ 131, 132, 304.

³ For the right of a corporation to mortgage its franchises, see § 304.

A power in the corporation to mortgage or transfer its franchises is as-

sumed for the purposes of the present discussion.

⁴ *Wright v. Milwaukee, etc. Ry. Co.*, 25 Wis. 46, and cases in next notes. Compare *Pfeifer v. Sheboygan, etc. R. R. Co.*, 18 Wis. 155; *McLellan v. Detroit File Works*, 56 Mich. 579. But by special provision a successor may be liable. *New Bedford R. R. Co. v. Old Colony R. R. Co.*, 120 Mass. 397. Thus, a corporation organized under and pursuant to

hand, it is usually held that the consolidated corporation assumes all the liabilities of the corporations of which it is composed.¹ Thus, when the property and franchises of a railroad company are sold out under the foreclosure of a mortgage, the purchasers are not liable on a judgment against the corporation,² although they organize and form a corporation under the name used by the old company.³ And a company which purchases the railroad of another corporation, sold for the payment of its debts, is not responsible for the damages which, at the time of the sale, had already accrued to adjoining lands through failure of the former company to maintain proper drainage.⁴ So when a railroad company competently purchases at a foreclosure sale the franchises and property of another company, it will be affected only by such contracts of the other as constitute a lien upon or otherwise bind the property and franchises thus acquired. The purchasing company will not be bound, for instance, by a contract of the former company not to extend the railroad in a certain direction.⁵

On the other hand, a railroad company whose road has been sold out under foreclosure, is not liable for injuries received on the road after it had passed from the control of the company.⁶

an agreement sanctioned by competent legislation, is bound by its provisions, and by all the liabilities it imposes in favor of third persons. *Welsh v. First Div. St. Paul, etc. R. R. Co.*, 25 Minn. 314. See also *St. Louis A. and T. R. R. Co. v. Miller*, 43 Ill. 199. If the succeeding corporation assumes them, it will be bound. *Island City Savings Bank v. Sachtleben*, 67 Tex. 420.

¹ *Sappington v. L. R. M. R. and T. R. R. Co.*, 37 Ark. 23. See §§ 425-427.

² *Pennsylvania Transportation Co.'s Appeal*, 101 Pa. St. 576; *Vilas v. Milwaukee, etc. R. R. Co.*, 17 Wis. 497; *Smith v. Chicago and N. W. Ry. Co.*, 18 Wis. 17; *Hatcher v. Toledo, etc. R. R. Co.*, 62 Ill. 477; *Gilman v. Sheboygan, etc. R. R. Co.*,

37 Wis. 317; *Cook v. Detroit, etc. Ry. Co.*, 43 Mich. 349. See *Lake Erie and N. Ry. Co. v. Griffin*, 92 Ind. 487.

³ *Memphis Water Co. v. Magens*, 15 Lea (Tenn.), 37.

⁴ *Hammond v. Port Royal, etc. R. R. Co.*, 15 S. C. 10; *Same v. Same*, 16 S. C. 567. See *Neff v. Wolf River Boom Co.*, 50 Wis. 585.

⁵ *City of Menasha v. Milwaukee, etc. R. R. Co.*, 52 Wis. 414. See *Tawas, etc. R. R. Co. v. Circuit Judge*, 44 Mich. 479; *Morgan County v. Thomas*, 76 Ill. 120. But see *Rome, etc. R. R. Co. v. Ontario, etc. R. R. Co.*, 16 Hun (N. Y.), 445; and compare *Chicago and A. R. R. Co. v. Chicago, etc. Coal Co.*, 79 Ill. 121.

⁶ *Western R. R. Co. v. Davis*, 66 Ala. 578.

§ 416. Since the purchaser can acquire no further or more unrestricted franchises than were possessed by the original corporation, in availing himself of its franchises he will be bound by all the restrictions to which they were subject in its hands. Thus, when in pursuance of a statute the railroad of one company is purchased by another, unless there is some express provision of law to the contrary, the road passes to the purchaser subject to the restrictions as to the rates chargeable for transportation which attached to it in the hands of the vendor.¹ And the corporation competently purchasing the property, privileges, rights, and franchises of another railroad company thereby assumes the continuing obligations and responsibilities imposed by the constitution of the other.² Reversely, when a railroad company takes a lease of another road, it will be subject in regard to the taking of tolls thereon only to the restrictions contained in the charter of its lessor, and not to those contained in its own.³

Property passes subject to restrictions.

§ 417. It is in accordance with these principles that when a corporation or an individual, be he an ordinary purchaser or one who receives the property in the carrying out of some trust, comes into the possession of the property and franchises of a corporation, like a railroad company, exercises the franchises and uses the property, he thereby assumes towards outsiders a position and responsibility similar to those of the former company. Thus, trustees under a railroad mortgage, who have bought in the road on foreclosure, and are operating it for the benefit of the bondholders, will be regarded, as towards the public, as owners

Successor assumes position of former corporation.

¹ *Campbell v. Marietta, etc. R. R. Co.*, 23 Ohio St. 168.

² *Daniels v. St. Louis, etc. R. R. Co.*, 62 Mo. 43. See *Montgomery, etc. R. R. Co. v. Boring*, 51 Ga. 582. When a state bank pays a continuing bonus to the state for its privileges and franchises the state cannot exact the bonus after the bank has reorganized under the national banking act. *State v. National Bank*, 33 Md. 75. But the reorganized bank is liable for the

liabilities of the state bank. *Coffey v. National Bank*, 46 Mo. 140. When a state bank is transformed into a national bank, it is but a continuance of the same body under a changed jurisdiction, and the national bank can enforce contracts made with the state bank. *City Nat. B'k v. Phelps*, 97 N. Y. 44.

* *Pennsylvania R. R. Co. v. Sly*, 65 Pa. St. 205. See § 170.

in possession and will be liable as common carriers for all goods transported over the road during their management.¹ Likewise a receiver operating a road, sustains towards the public the relation of common carrier, and will be amenable to the common law courts in actions for negligence.²

§ 418. A person purchasing the property of a corporation does not necessarily acquire the special privileges or exemptions,³ and franchises possessed by the corporation with respect to its property.⁴ Especially the franchise of being a corporation may not pass;⁵ and thus, where certain persons purchased at a sheriff's sale all the rights, privileges, franchises, and property of a railroad corporation, and then operated the road themselves, they were held jointly liable on an obligation issued by them in the name of the corporation.⁶

Special exemptions may not pass.

¹ *Rogers v. Wheeler*, 43 N. Y. 598; *Pearson v. Wheeler*, 55 N. H. 41; *Sprague v. Smith*, 29 Vt. 421. See *Farrell v. Union Trust Co.*, 77 Mo. 475. Compare *Beeson v. Lang*, 85 Pa. St. 197; *Stratton v. European*, etc. R'y, 74 Me. 422.

² *Newell v. Smith*, 49 Vt. 255. Compare *Hopkins v. Taylor*, 87 Ill. 436; *Little v. Dusenberry*, 46 N. J. L. 614; *Klein v. Jewett*, 26 N. J. Eq. 474; *S. C.*, 27 N. J. Eq. 550; *Blumenthal v. Brainerd*, 38 Vt. 402; *Sloan v. Central Iowa Ry. Co.*, 62 Iowa, 728. Seems contra *Cardot v. Barney*, 63 N. Y. 281. A claim for personal injuries sustained while the road is in the hands of a receiver is against the funds of the receivership; and the receiver is not personally liable after he has turned over such funds to the purchasers and received his discharge. *Ryan v. Hays*, 62 Tex. 42.

And it seems that the corporation itself will not be liable for injuries received on its road, after the road had passed under the control of a receiver duly appointed, and taking active charge. *Bell v. Indianapolis, etc. R. R. Co.*, 53 Ind. 57. But see *Indianapolis, etc. R. R. Co. v. Ray*, 51 Ind. 269. See § 170.

³ See §§ 487-491.

⁴ Special privileges conferred on a railroad corporation by special charter, *e. g.*, the right to demand special rates of fare, are not so inherent in the road as to pass to any corporation or person authorized to work it. *Pittsb., Cin., etc. R'y Co. v. Moore*, 33 Ohio St. 384. But compare *Detroit v. Mutual Gas Co.*, 43 Mich. 594.

⁵ See §§ 131, 132.

⁶ *Chaffé v. Ludeling*, 27 La. Ann. 607; compare *Beeson v. Lang*, 85 Pa. St. 197.

5. CONSOLIDATION.

No implied power to consolidate, § 419.	Essential questions, § 423.
Authority to consolidate, § 420.	Capacities of consolidated corporation,
Effect of consolidation, § 421.	§ 424.
Meaning of phrases, § 422.	Its liabilities, §§ 425-427.

§ 419. It is almost self-evident that a corporation has no implied power to consolidate with another. Special authority from the legislature is necessary.¹ Reasons for this are twofold. In the first place, since a consolidation ordinarily brings a new corporation into existence,² the authority of the legislature is as necessary for the incorporation of a company out of pre-existing corporations as it is under other circumstances. And in the second place, the rights of dissenting shareholders would be impaired; for the implied agreement made by every one subscribing for shares, that the corporate affairs shall be subject to the will of the majority and of the corporate management, does not extend beyond the doing of acts contemplated in the original constitution.³

No implied
power to
consoli-
date.

§ 420. The authority to consolidate may exist in the original constitution of the corporation;⁴ or it may be given by a subsequent statute passed before consolidation;⁵ or an unauthorized consolidation may be ratified by statute after it has taken place.⁶ And power given to a corporation to consolidate with any other is sufficient to another corporation, if it choose, to unite with the former, although the

Authority
to consoli-
date.

¹ *Pearce v. Madison, etc. R. R.*, 21 How. 442; *Clearwater v. Meredith*, 1 Wall. 25.

² § 421.

³ *Clearwater v. Meredith*, 1 Wall. 25, 40. See § 536 for the right of a shareholder to prevent a consolidation.

⁴ *Nugent v. Supervisors*, 19 Wall. 241.

⁵ See *Black v. Delaware and Rar. Canal Co.*, 24 N. J. Eq. 455. A state

may authorize two or more existing corporations to organize themselves into a new corporation just as much as it may authorize individuals to incorporate themselves. *State Treasurer v. Auditor-General*, 46 Mich. 224, 233.

⁶ *Bishop v. Brainerd*, 28 Conn. 289; *Mead v. New York, Housatonic, etc. R. R. Co.*, 45 Conn. 199. See *McAuley v. Columbus, etc. R'y Co.*, 83 Ill. 348.

latter is not named in the statute.¹ Corporations incorporated by different states may be united by consolidation.²

§ 421. When two or more corporations are consolidated, the legal relations thereby occasioned depend primarily on the intention of the legislature as expressed in the statute authorizing the consolidation.³ Generally the effect is to dissolve all the corporations consolidating, and to create a new corporation out of their elements.⁴ But consolidation does not necessarily work a dissolution of all the consolidating corporations; and one may become merged in the other, the latter continuing its corporate existence.⁵

§ 422. The phrases used in the preceding paragraph require analysis. When it is said, that whether or not a dissolution of both corporations and a creation of a new one are occasioned, depend on the intention of the legislature, the word "corporation" is obviously used as meaning legal institution, or the sum of the legal relations subsisting in respect of the corporate enterprise.⁶ Evidently questions

¹ Matter of Prospect Park, etc. R. R. Co., 67 N. Y. 371. See New York and N. E. R. R. Co. v. New York, etc. R. R. Co., 52 Conn. 274.

² See Muller v. Dows, § 408, and generally for status of such a corporation, see §§ 403 *et seq.*; also Racine, etc. R. R. Co. v. Farmers' Loan and Trust Co., 49 Ill. 331.

³ Central R. R., etc. Co. v. Georgia, 92 U. S. 665; Railroad Co. v. Georgia, 98 U. S. 359.

⁴ Railroad Co. v. Georgia, 98 U. S. 359; Clearwater v. Meredith, 1 Wall. 25; McMahon v. Morrison, 16 Ind. 172; State v. Bailey, *ib.* 46; Shields v. Ohio, 95 U. S. 319; Ridgway Township v. Griswold, 1 McCrary, 151; Cheraw, etc. R. R. Co. v. Commissioners, 88 N. C. 519; Fee v. New Orleans Gas Light Co., 35 La. Ann. 413.

⁵ Philadelphia, etc. R. R. Co. v. Maryland, 10 How. 376; Central R. R., etc. Co. v. Georgia, 92 U. S. 665.

"When the rights, franchises, and effects of two or more corporations are by legal authority and agreement of the parties combined and united into one whole and committed to a single corporation, the shareholders of which are composed of those (so far as they choose to become such) of the companies thus agreeing, this is in law and according to common understanding a consolidation of such companies, whether such single corporation, called the consolidated company, be a new one then created, or one of the original companies continuing in existence with only larger rights and capacities and property." Meyer v. Johnston, 64 Ala. 603, 656; opinion of court per Manning, J. Because the consolidated company has a new name does not make it a new corporation, *ib.* In this case it was held that no new corporation was created.

⁶ See Chap. III.

arising on consolidation are questions as to what already subsisting legal relations continue, and what new legal relations are occasioned through the consolidation. Hence, by saying that a new corporation is created, is meant that the legal relations are substantially changed as a body; and that future legal relations will depend on a different corporate constitution. And by saying that corporation B. is merged into corporation A., is meant that the constitution of A., as an organic group of laws, remains unchanged; though it may be modified by bringing into it certain legal rules from the constitution of B.

§ 423. In accurate and minute discussions, however, of special questions arising on consolidation, usually but small assistance will be derived from considering whether or not a new corporation is created. The essential matter will be to determine from the statutes authorizing the consolidation how far the already subsisting legal relations are modified; and how far are altered the legal rules under which legal relations in respect of the corporate enterprise will come into existence upon the doing of further acts. Essential questions.

§ 424. All the rights and franchises of the consolidated corporation are subject to the provisions of the statute authorizing the proceeding.¹ Usually, however, all the franchises of the consolidating companies vest in the new corporation; as well as all the rights which before consolidation had accrued or vested in the former corporations under the exercise of their franchises.² Thus, authority Capacities of the consolidated corporation.

¹ *Shields v. Ohio*, 95 U. S. 319; affirming S. C., 26 O. St. 86.

² *Payne v. Lake Erie, etc. R. R. Co.*, 31 Ind. 283; *Miller v. Lancaster*, 5 Coldw. (Tenn.) 514; *Cooper v. Corbin*, 105 Ill. 224. Thus, the new corporation may lawfully use a patent which the prior companies had been licensed to use. *Lighter v. Boston and Albany R. R. Co.*, 1 Lowell, 338; *Ridgway Township v. Griswold*, 1 McCrary, 151. So when the officers of a corporation are exempt from jury duty, and the corporation consolidates, the consolidated corporation receiving

all the immunities of the former corporations, its officers will be exempt from jury duty; and that they should be so is a valuable franchise of the corporation. *Zimmer v. State*, 30 Ark. 677. See also *Fisher v. N. Y. C. and H. R. R. R. Co.*, 46 N. Y. 644. It is to be presumed, when two or more railroad companies are authorized to consolidate, that the franchises and privileges of each continue to exist with respect to the several roads so consolidated. Authority to consolidate "upon such terms as may be deemed just and proper" includes the

to mortgage the franchises may pass to the consolidated company;¹ and likewise the power of eminent domain.²

§ 425. On the other hand, the consolidated corporation not only assumes duties and obligations similar to those of the former corporations, but as a general rule will be held liable on the very identical liabilities and obligations incurred by either of the former companies. Accordingly, the new corporation may be held liable for the torts of the consolidated companies committed before consolidation.³

§ 426. Evidently the consolidated company, by the statutes allowing or ratifying the consolidation, may be made to assume all the liabilities of the former companies to their creditors,⁴ or the terms of the consolidation and the statutes authorizing it may expressly or by implication prevent such liability from arising.⁵ In the absence of provision, however, by which the consolidated corporation is made to assume or is kept free from such liabilities, it has been held that where two or more railroad corporations are consolidated, the consolidated company, so far as the creditors of one of the original companies are concerned, is a successor of that particular company only in respect of the property formerly belonging to it; and in respect of the properties of the other companies, the consolidated company is

power to transfer to the consolidated company the franchises and privileges connected with the road; if, indeed, the law itself did not have that effect. *Green County v. Conness*, 109 U. S. 104, citing *Tomlinson v. Branch*, 15 Wall. 460; see § 491.

As to whether special exemptions, as, *e. g.*, from taxation, pass to the consolidated corporation, see §§ 487-491. As to the right of the consolidated corporation to municipal bonds voted in aid of one of the former companies, see § 323. As to consolidation releasing subscribers, see § 536.

¹ *Mead v. N. Y., Housatonic, etc. R. R. Co.*, 45 Conn. 199.

² *South Carolina R. R. Co. v. Blake*, 9 Rich. L. (S. C.) 228, 233.

³ *Chicago R. I. and Pac. R. R. Co. v. Moffatt*, 75 Ill. 524; *Coggin v. Central R. R. Co.*, 62 Ga. 685; *Texas and P. R. R. Co. v. Murphy*, 46 Tex. 356. See *Columbus, Chicago, etc. R'y Co. v. Skidmore*, 69 Ill. 566; *Indianola R. R. Co. v. Fryer*, 56 Tex. 609; compare *Houston, etc. R. R. Co. v. Shirley*, 54 Tex. 125; *St. Louis and S. F. R. R. v. Marker* 41 Ark. 542.

⁴ See *Western Un. R. R. Co. v. Smith*, 75 Ill. 496; *Warren v. Mobile, etc. R. R. Co.*, 49 Ala. 582.

⁵ *Shaw v. Norfolk County R. R. Co.*, 8 Allen (Mass.) 407; *Whipple v. Union Pac. Ry. Co.*, 28 Kan. 474.

a new and independent company, on which such creditors have no claim upon their original contracts, but only by virtue of its assumption of the obligations of the old companies.¹

§ 427. The rationale of these different cases, and especially of *Prouty v. Lake Shore, etc. R. R. Co.*, will be more apparent if the matter be considered from the point of view of the rights of the former corporations' creditors as against the consolidated company and the property which it has acquired through consolidation, rather than from the point of view of that corporation's liability to them. A creditor cannot prevent a corporation which owes him money from consolidating with another; but, on the other hand, his rights respecting the property of his debtor—which constitutes a trust fund for the payment of its debts—cannot be affected by its consolidation with another corporation.² He can follow this trust fund into the hands of the consolidated corporation; and his rights in regard to the property of his debtor are certainly prior to the rights of the creditors of the other consolidating companies. The idea of consolidation seems to imply responsibility on the part of the consolidated corporation for the debts of the former companies: the rights of the creditors of each consolidating company are unaffected by the consolidation: the outcome is, that the consolidated corporation is personally liable for all the debts of the former companies; but the equitable lien which each group of creditors has on the property of their debtor corporation pre-

¹ *Prouty v. Lake Shore, etc., R. R. Co.*, 52 N. Y. 363. Similarly, in regard to the officers of the consolidated company, in so far as the trust devolves upon them of managing the property of the old company, they are the successors of its officers and bound by proceedings against them. *Prouty v. Lake Shore, etc. R. R. Co., supra.*

Although the (Michigan) law subjects consolidated companies to the obligations of their constituents, yet the consolidation creates a new and distinct corporation, and a declaration

against it for a cause of action arising before consolidation should show against what company it arose, and aver such facts as will subject the new company to be sued on it. *Marquette, H. and O. R. R. Co. v. Langton*, 32 Mich. 251.

² See *Shackleford v. Miss. Central R. R. Co.*, 52 Miss. 159. Compare *Indianola R. R. Co. v. Fryer*, 56 Tex. 609; *Houston, etc. R. R. Co. v. Shirley*, 54 Tex. 125; *Whipple v. Union Pacific Ry. Co.*, 28 Kan. 474; *Hamlin v. Jerrard*, 72 Me. 62.

serves its validity and priority as against the creditors of the other corporations.¹

6. DISSOLUTION.

Definition, § 428.

Causes, §§ 429, 430.

Power to dissolve. Decree of dissolution when necessary, §§ 431, 432.

Surrender of franchises, §§ 433, 434.

Effect of a dissolution, §§ 435-437.

§ 428. The dissolution of a corporation is that condition of law and fact which ends the capacity of the body corporate to act as such, and necessitates a final liquidation and extinguishment of all the legal relations subsisting in respect of the corporate enterprise. The causes and general effect² of a dissolution may be considered in order.

§ 429. It is obvious that many common law rules regarding the causes of the dissolution of the older sorts of corporations, municipal, eleemosynary, and ecclesiastical, have no application to stock corporations at the present day. Thus, the rule that a dissolution is caused by a death of all the members cannot apply to a stock corporation; in which, if the shareholders die, their shares pass to other persons, either by bequest or under statutes of distributions.³ Likewise are inapplicable cases like that in Rolle's Abridgment, in which a corporation was said to be dissolved by the loss of an integral part; as when in a corporation composed of brothers and sisters all the latter die.⁴

¹ See *Shackleford v. Miss. Central R. R. Co.*, 52 Miss. 159. See further as to the rights of creditors on consolidation, §§ 665, 666. A consolidated company is affected with notice of an unrecorded mortgage on the property of the corporations from which it is formed; and such mortgage will be good as against judgment creditors of the consolidated company who buy the mortgaged premises on execution. *Mississippi Valley Co. v. Chicago, etc. R. Co.*, 58 Miss. 846.

² The particular relations, arising on

dissolution between the corporation and the different classes of persons interested, and among the members of each class, are noticed in subsequent chapters. See §§ 610, 611, 664, 750, 751, 786.

³ *Mathis v. Morgan*, 72 Ga. 517; *Boston Glass Manufactory v. Langdon*, 24 Pick. 49, 52; *Russell v. McLellan*, 14 Pick. 63, 69. Compare *Newton M'f'g Co. v. White*, 42 Ga. 148.

⁴ 1 Rolle, Abr. 514. Likely it would have been otherwise in this case, had the brothers possessed the

§ 430. A stock corporation is dissolved by (1) forfeiture of its franchises; (2) repeal of its charter or enabling act,¹ when the power to repeal is reserved to the state; (3) surrender of its franchises to the state; (4) compliance with whatever statute may exist authorizing a voluntary dissolution; and (5) expiration of the time limited by the charter, or by the enabling act and articles of association for the continuance of the corporation.² The first two of these causes of dissolution are considered in the chapter on the relations between the corporation and the state.³ Some states, for instance New York⁴ and Massachusetts, have enacted statutes authorizing the voluntary dissolution of corporations; and when such a statute is complied with a judgment of dissolution may be obtained.⁵

§ 431. In an ordinary business corporation, where the rights of the public do not intervene, it is within the power of the body corporate, by a vote of the majority of shareholders, to discontinue the corporate business.⁶ But, as will appear by reference to the cases and instances hereafter cited, such action in itself would not ordinarily effect a dissolution so as, for instance, to prevent the corporation from being sued. A decree of dissolution from a court of competent jurisdiction is necessary in such cases.

Power to dissolve.
Decree of dissolution when necessary.

capacity of electing further sisters. See *Rose v. Turnpike Co.*, 3 Watts (Pa.), 46.

* ¹ The repeal of a general enabling act, however, will not work a dissolution of existing corporations, unless such an intention be clearly indicated in the repealing act. See § 504.

² See *Asherville Division v. Aston*, 92 N. C. 578. Where a statute provided that corporations formed under it should have succession for a period of twenty years, when no period was limited in their charters, and a corporation was formed with "perpetual succession," it was held only to mean unbroken continuity, and that the corporation ceased in twenty years. *Scan-*

lan v. Crawshaw, 5 Mo. App. 337. But in its natural signification, when not limited by the context, "perpetual succession" denotes indefinite duration, and the corporation has the right to exist forever. *Fairchild v. Masonic Hall Ass'n*, 71 Mo. 526.

³ §§ 457 *et seq.*, and §§ 496 *et seq.* See also § 664, for the rights of creditors.

⁴ N. Y. Code of Civil Procedure, §§ 2419 *et seq.* See *Matter of Pyrolusite Manganese Co.*, 29 Hun, 429.

⁵ For a construction of the New York statute, see *Herring v. N. Y. etc. R. R. Co.*, 105 N. Y. 340.

⁶ *Treadwell v. Salisbury M'f'g Co.*, 7 Gray, 393, 404. See §§ 610, 611.

§ 432. If a corporation is dissolved by the repeal of its charter pursuant to an unconditional power of repeal reserved to the state, or if its term of existence has expired, no judicial decree is necessary to effect a dissolution.¹ And when the corporation is to cease upon the happening of some contingency, it is held that thereupon a dissolution takes place without any decree.² But to effect this the intention of the statute must be very clear; for, although a certain event may expressly be made a ground of forfeiture, the forfeiture must be judicially declared.³ And, indeed, the better opinion would seem to be that, for most purposes, the happening of the contingency upon which the corporation is to cease should also be judicially declared.⁴

Subject to the exceptions already stated, the general rule is that the decree of a court of competent jurisdiction is necessary to effect the dissolution of a corporation.⁵ Accordingly, a failure to elect corporate officers,⁶ or a discontinuance of business by the corporation,⁷ does not effect its dissolution; nor does

¹ See § 503. *Sturgess v. Vanderbilt*, 73 N. Y. 384; *People v. Walker*, 17 N. Y. 502; *Bank of Gallipolis v. Trimble*, 6 B. Mon. (Ky.) 599, 601; *Terry v. Merchants', etc. Bank*, 66 Ga. 117; *Bank of Miss. v. Wrenn*, 3 Sm. & M. (Miss.) 791; see *Lagrange, etc. R. R. Co. v. Rainey*, 7 Coldw. (Tenn.) 420.

² *In re Brooklyn, Winfield, etc. R. R. Co.*, 75 N. Y. 335; *Brooklyn Steam Transit Co. v. Brooklyn*, 78 N. Y. 524.

³ *La Grange, etc. R. R. Co. v. Rainey*, 7 Coldw. (Tenn.) 420. See § 153.

⁴ § 458, also § 153.

⁵ *Kincaid v. Dwinelle*, 59 N. Y. 548; *Moore v. Schoppert*, 22 W. Va. 282. See § 458.

⁶ *Rose v. Turnpike Co.*, 3 Watts (Pa.), 46; *Lehigh Bridge Co. v. Lehigh Coal Co.*, 4 Rawle (Pa.), 8, 23; *Commonwealth v. Cullen*, 13 Pa. St.

133; *Blake v. Hinkle*, 10 Yerg. (Tenn.) 218; *Nashville Bank v. Petway*, 3 Humph. (Tenn.) 522; *Boston Glass Manufactory v. Langdon*, 24 Pick. 49; *Russell v. M'Lellan*, 14 Pick. 63; *Knowlton v. Ackley*, 8 Cush. 93; *Cahill v. Kalamazoo Mut. Ins. Co.*, 2 Dougl. (Mich.) 124, 140; *Philips v. Wickham*, 1 Paige (N. Y.) 590; *Slee v. Bloom*, 5 Johns. Ch. (N. Y.), 366, 377; *S. C.*, 19 Johns. 456; *People v. Twaddell*, 18 Hun, 427; *Evarts v. Killingworth M'fg Co.*, 20 Conn. 447; *Harris v. Miss. Valley, etc. R. R. Co.*, 51 Miss. 602; *Smith v. Smith*, 3 Dessaur. (S. C.) 557; *St. Louis Domicile, etc. Ass'n v. Augustin*, 2 Mo. App. 123.

⁷ *Kansas City Hotel Co. v. Sauer*, 65 Mo. 279, 288; *Nimmons v. Tappan*, 2 Sweeny (N. Y.), 652; *Mickles v. Rochester City Bank*, 11 Paige (N. Y.), 118; *Moseby v. Burrow*, 52 Tex. 396; *State v. Barron*, 58 N. H. 370.

its insolvency.¹ Neither does a dissolution result where the corporation is insolvent, and has ceased to do business as well;² even when it has assigned all its property for the benefit of its creditors,³ or a receiver has been appointed.⁴ It has even been held that the fact that a corporation is insolvent will not authorize it to apply to a court of equity for a receiver to wind up its affairs, in order to prevent one creditor from acquiring by suit a preference over others; the court saying, that a receiver might be appointed at the instance of a creditor, but not at the instance of an insolvent debtor.⁵

§ 433. It is said very generally in older cases, that a corporation cannot validly surrender its franchises unless the state accepts them. "Charters are in many respects compacts between the government and the corporators. As the former cannot deprive the latter of their franchises in violation of the compact, so the latter cannot put an end to the compact without the consent of the former. It is equally obligatory on both parties. The surrender of a charter

Surrender
of fran-
chises.

Compare *Matter of Jackson Marine Ins. Co.*, 4 Sand. Ch. (N. Y.) 559; *Conro v. Gray*, 4 How. Pr. (N. Y.) 166; *Troy and Rutland R. R. Co. v. Kerr*, 17 Barb. 581. A railroad company is not dissolved by a sale of its road. *State v. Rives*, 5 Ired. L. (N. C.) 297.

¹ *Moseby v. Burrow*, 52 Tex. 396; *Shenandoah Valley R. R. Co. v. Griffith*, 76 Va. 913. Cases in the following notes.

² *Valley Bank v. Sewing Society*, 28 Kan. 423. A national bank in voluntary liquidation under § 5220 of the U. S. Rev. Stat. is not thereby dissolved as a corporation, but may sue and be sued by name for the purpose of settling disputed claims against its assets, even though the plaintiff may have filed a creditor's bill to enforce the individual liability of shareholders. *National Bank v. Insurance Co.*, 104 U. S. 54.

³ *Boston Glass Manufactory v. Langdon*, 24 Pick. 49; *Town v. Bank of River Raisin*, 2 Dougl. (Mich.) 530; *De Camp v. Alward*, 52 Ind. 468; *State v. Bank of Maryland*, 6 G. & J. 205.

⁴ *Kincaid v. Dwinelle*, 59 N. Y. 548; *Lea v. American, etc. Canal Co.*, 3 Abb. Pr., N. S. (N. Y.), 1, 11; *City Ins. Co. v. Commercial Bank*, 68 Ill. 348; *Bank of Bethel v. Pahquioque Bank*, 14 Wall. 383; *Green v. Walkill Nat. B'k*, 7 Hun, 63; *Moseby v. Burrow*, 52 Tex. 396; *State v. Railroad Commissioners*, 41 N. J. L. 235; *Heath v. Missouri, etc. Ry. Co.*, 83 Mo. 617. Compare *Bell v. Indianapolis, etc. R. R. Co.*, 53 Ind. 57; *Indianapolis, etc. R. R. Co. v. Ray*, 51 Ind. 269.

⁵ *Hugh v. McRae*, Chase's Dec. 466. See *Kimball v. Goodburn*, 32 Mich. 10; *New York Marbled Iron Works v. Smith*, 4 Duer (N. Y.), 362.

can only be made by some formal act of the corporation; and will be of no avail until accepted by the government. There must be the same agreement to dissolve that there was to form the compact. It is the acceptance which gives efficacy to the surrender. The dissolution of a corporation, it is said, extinguishes all its debts. The power of dissolving itself by its own act would be a dangerous power, and one which cannot be supposed to exist."¹ It is also said that "the modes in which a surrender is to be made, and as to what facts constitute a surrender, have been a fruitful subject of discussion in the courts of this country. In England, the surrender is by deed to the king, by whom corporations are usually created by charter. In this country, corporations are created by an act of the legislature, and it would seem to follow, in the absence of any statute prescribing the mode in which a surrender is to be made, that to become available, it must be accepted by the authority which created the corporation."²

§ 434. The present applicability of the preceding citations to stock corporations is somewhat doubtful. Formerly, corporations usually received special charters; but now stock corporations at least are almost universally organized under general enabling acts. A mode of dissolution is ordinarily provided; and if no such provision exists, the most experienced legal adviser might be puzzled to advise how an acceptance of the surrender of franchises could be brought about, unless by lobbying a special bill through the legislature. Besides, the idea of the necessity of the acceptance of a surrender of franchises on the part of the authority granting them, seems intimately connected with the old doctrine—now certainly a thing of the past—that on the dissolution of a corporation all its debts were extinguished. There seems to be no valid reason why an ordinary stock corporation, charged with the performance of no

¹ *Boston Glass M'f'y v. Langdon*, 24 Pick. 49, 58. *Accord*, *Town v. Bank of River Raisin*, 2 Dougl. (Mich.) 530, 538; *La Grange, etc. R. Co. v. Rainey*, 7 Coldw. (Tenn.) 420, 438; *Revere v. Boston Copper Co.*, 15 Pick. 351; *Mechanics' Bank v. Heard*, 37 Ga. 401; *Wilson v. Proprietors, etc.* 9 R. I. 590; *Norris v. Mayor of Smithville*, 1 Swan (Tenn.), 164; 2 Kent's Com., 311.

² *Town v. Bank of River Raisin*, 2 Dougl. (Mich.) 530, 538.

public duty, should not be allowed to close up its business at any time, and dissolve.¹

§ 435. The consequences of a dissolution are both substantial and formal. The substantial consequences are that the business is wound up, and all the legal relations subsisting in respect of the corporate funds are liquidated. The formal consequences are that the corporation can no longer act as such either before the courts or in business transactions.² Accordingly, the liquidation of its affairs will ordinarily have to be conducted by a receiver or other officer appointed for that purpose. After its dissolution the corporation can institute no suit, nor be made a party defendant;³ and all suits already brought by or against it are abated.⁴ And judgment cannot be entered against it.⁵

Effect of a dissolution.

§ 436. It is the legislative policy of some states to prolong the existence of the corporation after the expiration of its charter, for the purpose of winding up its affairs, though not for the purpose of continuing its business.⁶ Under such circumstances, whether any given legal proceeding should be insti-

¹ If the rights of the public intervene, the state would seem at least to have the right to compel the corporation to continue its business; however impracticable the actual assertion of any such right might be. See §§ 454, 455, and *State v. Western, etc. R. R. Co.*, 95 N. C. 602.

² *Saltmarsh v. Planters', etc. Bank*, 17 Ala. 761. See § 504.

³ *Saltmarsh v. Planters', etc. Bank*, 17 Ala. 761; *City Ins. Co. v. Commercial Bank*, 68 Ill. 348; *Bank of La. v. Wilson*, 19 La. Ann. 1; *Muscantine Turn Verein v. Funck*, 18 Iowa, 469; *Miami Exporting Co. v. Gano*, 13 Ohio, 269. See *Cooper v. Oriental Savings Association*, 100 Pa. St. 402.

⁴ *National Bank v. Colby*, 21 Wall. 609; *Terry v. Merchants', etc. Bank*, 66 Ga. 177; *Greely v. Smith*, 3 Story, 657; *Merrill v. Suffolk Bank*, 31 Me. 57; *Ingraham v. Terry*, 11 Humph.

(Tenn.) 572; *Mumma v. Potomac Co.*, 8 Pet. 281; *Farmers', etc. Bank v. Little*, 8 W. & S. (Pa.) 207; *Bank of Miss. v. Wrenn*, 3 Sm. & M. (Miss.) 791; *May v. State Bank*, 2 Rob. (Va.) 56; *Thornton v. Marginal Freight R'y Co.*, 123 Mass. 32; *McCulloch v. Norwood*, 58 N. Y. 566; compare *Platt v. Archer*, 9 Blatchf. 559; *Fisk v. Union Pac. R. R. Co.*, 10 Blatchf. 518. Contra, *Lindell v. Benton*, 6 Mo. 361.

⁵ *Dobson v. Simonton*, 86 N. C. 492. See cases in last note. Where the answer shows that the plaintiff was a corporation at the date of the contract sued on, the fact of its subsequent dissolution will not avail to reverse a judgment in its favor. *Kansas City Hotel Co. v. Sauer*, 65 Mo. 279.

⁶ See *Life Ass'n of America v. Fasset*, 102 Ill. 315; *St. Louis, etc. Coal*,

tuted in the corporate name, or in the name of a receiver or of trustees appointed to wind up the corporate affairs, depends on the statutory provisions.¹

§ 437. In regard to the substantial effects of a dissolution, clearly the common law rule that upon the dissolution of a corporation, its real estate reverts to the grantor, its personal property to the sovereign, and all debts due from and to it become extinguished,² has no longer any application to stock corporations. And that it has no application is the combined result of statutes and equitable principles.³ On the dissolution of a stock corporation its assets become a trust fund for the discharge of its liabilities, including those not yet matured,⁴ and the surplus belongs to the shareholders.⁵ Equity will always furnish a means by which debts due a corporation can be collected after its dissolution, for the benefit of parties interested, creditors or shareholders,⁶ and in equity the general assignee of a defunct corporation can collect its claims.⁷

etc. *Co. v. Sandoval Coal Co.*, 111 Ill. 32; *Folger v. Chase*, 18 Pick. 63; *Herron v. Vance*, 17 Ind. 595; *Tuscaloosa Scientific, etc. Ass'n v. Green*, 48 Ala. 346.

¹ See *Mariners' Bank v. Sewall*, 50 Me. 220; *Blake v. Portsmouth, etc. R. R. Co.*, 39 N. H. 435; *Tuscaloosa, etc. Ass'n v. Green*, 48 Ala. 346; *Re Independent Ins. Co.*, 1 Holmes, 103; *Von Glahn v. De Rosset*, 81 N. C. 467; *Muscantine Turn Verein v. Funck*, 18 Iowa, 469; *Pomeroy's Lessee v. State Bank*, 1 Wall. 23; *Lothrop v. Stedman*, 13 Blatchf. 134, 143; *Owen v. Smith*, 31 Barb. 641; *Heath v. Barmore*, 50 N. Y. 302; *Wright v. Nostrand*, 94 N. Y. 31; *State v. Bank of Washington*, 18 Ark. 554; *Cooper v. Oriental Savings Association*, 100 Pa. St. 402; *Gray v. Lewis*, 94 N. C. 392.

² See *Ang. and Ames on Corp.* § 779; *Life Ass'n of America v. Fassett*, 102 Ill. 315. But this rule was applied in *Commercial Bank v. Lockwood*, 2 Harr. (Del.) 8.

³ See *Owen v. Smith*, 31 Barb. 641; *Heath v. Barmore*, 50 N. Y. 302; *McCoy v. Farmer*, 65 Mo. 244.

⁴ *People v. National Trust Co.*, 82 N. Y. 283. The dissolution of a corporation does not terminate a lease to it. *Ib.* Compare *People v. Flint*, 64 Cal. 49.

⁵ *Heman v. Britton*, 88 Mo. 549. See *St. Louis, etc. Coal, etc. Co. v. Sandoval Coal, etc. Co.*, 116 Ill. 170.

⁶ See *Hightower v. Thornton*, 8 Ga. 486; *Curran v. State of Arkansas*, 15 How. 304, 311; *Von Glahn v. De Rosset*, 81 N. C. 467.

⁷ *Lenox v. Roberts*, 2 Wheat. 373; *Lum v. Robertson*, 6 Wall. 277. See *Bacon v. Cohea*, 12 Sm. & M. (Miss.) 516; compare *Fox v. Horah*, 1 Ired. Eq. (N. C.) 358; *Asheville Division v. Aston*, 92 N. C. 578.

After payment of debts of the corporation its surplus assets belong to the shareholders. *Burrall v. Bushwick R. R. Co.*, 75 N. Y. 211; *Lum v. Robertson*, *supra*, and see §§ 750, 751.

CHAPTER VIII.

RELATIONS BETWEEN THE STATE AND THE CORPORATION,¹
INCLUDING RELATIONS BETWEEN THE STATE AND (a)
SHAREHOLDERS, (b) OFFICERS, AND (c) CREDITORS OF
THE CORPORATION.

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¹ Relations, that is to say, between the state and the organic body of shareholders controlling the corporate en-

terprise, and representing all persons in any way interested in it.

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§ 438. THE constitution of a corporation is of a dual nature;

Dual nature of the constitution of a corporation.

it is law in that it consists of rules for conduct set by a political superior to political inferiors, and it embodies a contract the obligation of which is the self-same constitution regarded as law. The contract embodied in the constitution always subsists among the corporators as parties thereto, and it may subsist between the corporation and the state, for the state is sometimes a party to it.¹

¹ "A charter is a law, but it is also something more than law, in that it contains stipulations which are terms of compact between the state as the one party, and the corporators as the other, which neither party is at liberty to disregard or repudiate, and which

are as much removed from the modifying and controlling power of legislation as would be the contracts of private parties." Flint, etc. Plank Road Co. v. Woodhull, 25 Mich. 99, 101, per Cooley, J.

On account of the dual nature of the constitution of a corporation it will be necessary, in order to analyze the relations between the state and the corporation, to determine in what respect this constitution, besides being law, is to be regarded as a contract. To this determination accurate notions of law and contract are prerequisite.

§ 439. "Every law," says Austin,¹ "or rule is a command. . . . Or rather laws or rules properly so called are a species of commands." Analyzing the nature of a Austin's analysis of a law. command, he proceeds: "If you express or intimate a wish that I shall do or forbear to do some act, and if you will visit me with some evil in case I comply not with your wish, the expression or intimation of your wish is a command. . . . The ideas then comprehended by the term command are the following: 1. A wish or desire conceived by a rational being that another rational being shall do or forbear; 2. An evil to proceed from the former and to be incurred by the latter, in case the latter comply not with the wish; 3. An expression or intimation of the wish by words or other signs." Then, continues Austin, when a command "obliges generally to acts or forbearances of a class, a command is a law or rule. . . . A law properly so called is therefore a command which obliges a person or persons, and as distinguished from a particular or occasional command, obliges generally to acts or forbearances of a class. . . . Laws and other commands are said to proceed from superiors, and to bind or oblige inferiors, . . . the term superiority here signifies might."

In another part of the same work, Austin, analyzing the nature of sovereignty, says: "Every positive law, or every law simply and strictly so called, is set by a sovereign person or a sovereign body of persons, to the member or members of the independent political society wherein that person or body is sovereign or supreme. . . . The superiority which is styled sovereignty, and the independent political society which sovereignty implies, is distinguished from other superiority, and from other society by the following marks or characters: 1. The bulk of the given society are in the habit of obedience or

¹ Province of Jurisprudence. Lecture I.

submission to a determinate or common superior, let that common superior be a certain individual person, or a certain body or aggregate of individual persons. 2. That certain individual or the certain body of individuals is not in the habit of obedience to a determinate human superior.”¹

§ 440. So far Austin. A later and acute writer, Professor Holland, gives the following definition of law: “A law in the proper sense of the term is a general rule of human action taking cognizance only of external acts, enforced by a determinate authority, which authority is human, and among human authorities is that which is paramount in a political society. More briefly, a general rule of external human action enforced by a sovereign political authority.”² And, finally, the definition given by Kent is this: “Municipal law is a rule of civil conduct prescribed by the supreme power of the state.”³

In one respect, perhaps, these various definitions may be found fault with. It may be said that they are not universally and historically correct, *i. e.*, that they correspond only to the conception of law, current among those nations of the Aryan race who have developed their institutions under the influence of the Roman law.⁴ But this objection amounts to little, as any definition of law not so vague as to be useless would be obnoxious to it; and for the present purpose the objection has no force, as we are only concerned with law as conceived to-day in America and England.

§ 441. Austin’s definition of a law, however, as a “command which obliges a person, or persons, to acts or forbearances of a class,” while, perhaps, unexceptionable when limited in its application to Roman and modern European and American notions of law, and when understood as Austin meant it, is, nevertheless, in respect of laws which manifest themselves in civil rights, somewhat misleading. Holland, as we have seen, calls a law “a general rule of external human action enforced by a sovereign political au-

The term
“com-
mand” mis-
leading.

¹ Province of Jurisprudence. Lec-
ture VI.

³ 1 Com. 507.

² System of Jurisprudence, 2d ed.,
p. 34.

⁴ See Maine’s Early History of In-
stitutions, chaps. 12 and 13.

thority," a definition which resembles Kent's definition of municipal law as "a rule of civil conduct prescribed by the supreme power of a state."¹ If we look closely into Austin's use of the term "command" it will appear that he means by it very much what Holland and Kent mean by the term "rule." But the term "command," except as applied to criminal law, is misleading in this respect, that a law which manifests itself in civil rights and liabilities is not an absolute or unconditional command to do or refrain; but its effect is merely to enable some one with the aid of the state to compel some one else to do or refrain. Within the field of criminal law it is eminently proper to call a law a command; for a criminal law—"thou shalt not kill"—is a command pure and simple, sanctioned or enforced by its giver of his own motion, and not at the request of some individual. But a civil law creates rights just as much as it imposes obligations,² and consequently to regard such a law as a command is seeing but one side of it.

§ 442. As Austin says, "Every legal right is the creature of a positive law; and it answers to a relative duty imposed by that positive law, and incumbent on a person or persons, other than the person or persons in whom the right resides. To every legal right there are, therefore, three several parties; namely, a party bearing the right, a party burdened with the relative duty, and a sovereign government setting the law through which the right and the duty are respectively conferred and imposed."³ "We may define a legal right," says Holland very clearly, "as a capacity residing in one man of controlling with the assent and assistance of the state the actions of others. That which gives validity to a

Definitions
of a "legal
right."

¹ Holland says, a law is a rule *enforced* by the sovereign, while Kent says, it is *prescribed* by the sovereign. Holland's phrase seems preferable, as laws may not always, with propriety, be said to be prescribed by the sovereign, unless the word "prescribed" is used in the sense of recognized; which is improper. Rules of the common law, grown up as they have from custom, have been recognized, but in no

proper sense prescribed by the state. The state recognizes them, sanctions them, *i. e.*, *enforces* them; as it also enforces rules which by legislation it properly speaking prescribes.

² Or, as I prefer to say, a civil law *manifests itself* in rights and liabilities, *i. e.*, in legal relations. See § 24.

³ Province of Jurisprudence. Lecture VI.

legal right is in every case the force which is lent it by the state. Anything else may be the occasion, but it is not the cause of its obligatory character."¹ And Austin says again: "A party has a right when another, or others, are bound or obliged by the law to do or forbear towards or in regard to him."²

§ 443. A right then, with its corresponding duty or liability, constitutes a legal relation, which, as it was attempted to show before,³ rather than a "creature" may properly be called a concrete instance or manifestation of law, subsisting between persons as to whom correlated conditions of fact are predicable.

§ 444. How do rules of law manifest themselves in legal relations? Let us illustrate. The following, roughly speaking, are rules of law: "to constitute a binding agreement there must be a consideration;" "a contract for the sale of chattels at a price exceeding fifty dollars must be in writing." The two rules may be combined into the following proposition: a written agreement to sell, for which there is a consideration, as for instance an agreement to buy, the state will enforce at the request of either party.⁴ This compound rule of law manifests itself in legal relations between A. and B. as soon as the following correlated conditions of fact are predicable of them: that A. has agreed with B. to sell certain chattels to B. for a specified price (over \$50); that B. has agreed with A. to buy those chattels of A. at that price:

¹ Jurisprudence, second ed. p. 62.

² "Pervading Notions Analyzed."

Another writer, viewing a right more exclusively from the standpoint of the possessor of it, says: "A legal right is nothing but a permission to exercise certain natural powers, and upon certain conditions to obtain protection, restitution, or compensation by the aid of the public force. Just so far as the aid of the public force is given a man, he has a legal right, and this right is the same whether his claim is founded in righteousness or iniquity." Holmes, "The Common Law," p. 214. It is,

perhaps, hard to see how a right in *personam* can be a "permission to exercise certain natural powers." The author seems rather to have in view rights in *rem*.

³ See § 24, note.

⁴ For simplicity's sake all reference as to how the state will enforce the agreement, as by awarding damages or specific performance, is omitted; as is also omitted reference to conditions precedent, which either party may have to perform before he can compel the other to perform.

and that this mutual agreement has been put in writing. With reference to its operation on A. and B. this rule may now be expressed thus: A. having agreed to sell to B., and B. having agreed to buy of A. certain goods for a certain price, and this agreement having been put in writing, at the instance of either party, the state will compel the other to perform as agreed. The last proposition may be separated into the following propositions expressing the rights and liabilities—the legal relations—between A. and B., in which the general rule of law before stated has manifested itself. A.'s right is with the aid of the state to compel B. (*i. e.*, A. *can* compel B.) to pay the price agreed on, and B.'s corresponding liability is to pay that price, A.'s right and B.'s liability constituting a legal relation between them. On the other hand, B.'s right is with the aid of the state to compel A. to deliver the chattels: and A.'s liability is to deliver them; B.'s right and A.'s liability again constituting a legal relation between them.

§ 445. It thus appears that rules of law which manifest themselves in private or civil rights and liabilities, are no unconditional commands from the state; the state merely standing ready to aid the person possessing the right. And it appears, moreover, that the only legal effect of an act (except in criminal or public law) is to bring the actor within the operation of rules of law, which thereupon manifest themselves in legal relations between the actor, and other persons affected by the act.¹

Legal effect
of an act.

§ 446. As a conclusion of the foregoing remarks, a definition of law adequate for the purposes of this chapter may be submitted. A law is a rule for conduct which manifests itself in a right and a liability—a legal relation—between persons of whom correlated conditions of facts are predicable, and is enforced by the state at the instance of the person in whose favor it has manifested itself in a right. And, in accordance with this definition, the constitution of a corporation may be said to be law, or to con-

The constitution of a corporation, in what respect a law.

¹ As to the legal effect of acts, see Holland's *Jurisprudence*, 2d ed., chap. 12; and an interesting discussion in a work by Dr. August Thon, entitled, "*Rechtsnorm und Subjectives Recht*," chap. 1. "*Die Norm und die Rechtsfolgen ihrer Uebertretung*."

sist of rules of law, in so far as it is a rule, or consists of rules, for conduct manifesting itself for themselves in legal relations between persons of whom correlated conditions of fact are predicable.

§ 447. It remains to determine on some proper notion of a contract, which shall be consistent with the notion reached of law. For the present purpose, all acts may be divided into two classes: (a) acts whose effect is to bring the actors within the operation of rules of law, which thereupon manifest themselves in legal relations; acts, in other words, which occasion (not cause) legal relations; (b) all other acts. Acts of the first class may be called acts having legal effect.

Now many acts which have legal effect are not done for the purpose of occasioning legal relations. For instance, if A. strikes B., A.'s object is not to occasion legal relations between them, but, nevertheless, such is the result of the blow, for B. thereby acquires a cause of action against A. Certain acts on the other hand are done with the immediate purpose of occasioning legal relations. Of these latter acts the chief variety¹ are called contracts, which are acts whereby the parties express their intention of occasioning legal relations between them. If the contract is what is called valid or binding, it effectuates the expressed intention of the parties, in that it occasions the legal relations which the parties expressed their intention to occasion. By the contract the parties have brought themselves within the operation of rules of law, which at the moment of the execution of the contract manifest themselves in the presumably desired legal relations.²

§ 448. Now may be explained what was meant at the beginning of this chapter by saying that the constitution of a corporation, besides being the group of legal rules which manifest themselves in legal relations in respect of the corporate enterprise, always embodies a contract among the corporators, and sometimes a contract between the corporation and the state. To

Notion of a contract. Two classes of acts.

¹ A tort may be committed in order to occasion legal relations; as when one man trespasses on another's land in order to acquire by user a right of way.

² An invalid contract, taken by itself, is not an act having legal effect.

say that it embodies a contract between the corporators means that it embodies the terms of an agreement whereby the parties have expressed their intention of occasioning legal relations which are manifestations of the rules of law composing the very constitution which embodies the contract. The rule of law which ordinarily manifests itself in legal relations upon the making of a valid contract, is simply that each contracting party may compel the others to perform their parts according to the intent and meaning of the agreement. But in this particular contract that causes incorporation, the terms through incorporation become themselves rules of law; and thus the constitution of a corporation embodies the expression of the intention of parties which causes these rules to operate. Further, to say that the state, from which emanate most of the rules of law composing the constitution, is a party to the agreement which the constitution embodies, means that the state has done an act whereby it has expressed its intention to bring itself within the operation of some law superior to itself, which thereupon manifests itself in legal relations between the state and the corporation, legal relations which the state cannot alter at its will,¹ since they are the manifestations of law superior to itself. That paramount law is expressed in the Constitution of the United States.

§ 449. The constitution of a corporation is law which the state could not impose on the corporators without their consent, and this because of certain restrictions on the power of a state contained in the Federal Constitution or existing in the common law.² By

Acceptance necessary on the part of the corporators.

¹ See *Danolds v. State of New York*, 89 N. Y. 36.

² See § 456, and note, in the present chapter. The king could not incorporate a body of men, except as a municipal corporation, without their consent. See *Rex v. Passmore*, 3 T. R. 199, 240. A charter must be accepted before incorporation can take place. A grant of a charter to those who have not applied for it is but an offer on the part of the state, which may be with-

drawn before acceptance. *State v. Dawson*, 16 Ind. 40; *Riddle v. Proprietors*, 7 Mass. 169, 184; *Ellis v. Marshall*, 2 Mass. 269, 277; *Smith v. Silver Valley M'g Co.*, 64 Md. 86. But it is not necessary to show a written instrument, or even a note of acceptance. Acceptance may be inferred from the exercise of corporate powers under the act; *e. g.*, the election of officers, the holding of meetings, the adoption of by-laws, etc. Acceptance

accepting a charter the incorporators subject themselves to duties, which, without their consent, the state could not have imposed upon them. Accordingly, the grant and acceptance of a charter are held to constitute an act whereby the actors have expressed their intention to occasion legal relations between them; that is to say, a contract has been made to which the state is a party.

§ 450. The state cannot alter any of its laws so as to affect legal relations in which the law has already manifested itself,

by directors acquiesced in by the corporation is sufficient. *Bank of United States v. Dandridge*, 12 Wheat. 64, 71; *Mutual Fire Ins. Co. v. Stokes*, 9 Phila. (Penn.) 80; *Trustees of School District v. Gibbs*, 2 Cush. (Mass.) 39; *Androscoggin Bridge v. Bragg*, 11 N. H. 102; *Sumrall v. Sun Mutual Ins. Co.*, 40 Mo. 27; *Augusta M'fg Co. v. Vertrees*, 4 Lea (Tenn.), 75. See *State v. Dawson*, 22 Ind. 272. Slight irregularities in mode of acceptance by directors, when by the charter they have power to accept an amendment, do not vitiate the acceptance. *Deaderrick v. Wilson*, 8 Bax. (Tenn.) 108, 126. So no formal acceptance of an amendment or of an act conferring new franchises need be shown. *Bangor, Oldtown, and M. R. R. Co. v. Smith*, 47 Me. 34; *Wetumpka and Coosa R. R. Co. v. Bingham*, 5 Ala. 657; *Illinois River R. R. Co. v. Zimmer*, 20 Ill. 654; *Palfrey v. Paulding*, 7 La. Ann. 363; *Lyons v. Orange, etc. R. R. Co.*, 32 Md. 18; *Cincinnati, Hamilton, etc. R. R. Co. v. Cole*, 29 Ohio St. 126. See *Vermont and C. R. R. Co. v. Vermont Central R. R. Co.*, 34 Vt. 2, 49, where the action of a stockholders' meeting in making contracts authorized by the amendment, no one objecting, was held an acceptance of it. But see *State v. Accommodation*

Bank, 26 La. Ann. 288; *Commonwealth v. Cullen*, 13 Pa. St. 133. But a resolution to accept an amendment does not constitute an acceptance, unless it purport to accept unconditionally. *Mulloy v. Nashville and Decatur R. R. Co.*, 8 Lea (Tenn.), 427. A corporation already in existence may receive a new charter without relinquishing its old one, and may act partly under the new and partly the old charter. *Woodfork v. Union Bank*, 3 Coldw. (Tenn.) 488. Statutes may provide that upon the acceptance by existing corporations of their provisions, such corporations shall be held to have abandoned rights under their charters inconsistent with such statutes. Such acceptance need not be formal, but may be inferred from action in accordance with the provisions of such statutes. *Cincinnati, H. and D. R. R. Co. v. Cole*, 29 O. St. 126. A corporation is not estopped by the acts of individual officers or members in procuring legislation; when it does not appear that they had authority to procure such legislation or that the corporation had accepted it. *Mississippi, etc. Boom Co. v. Prince*, 34 Minn. 79. Compare *Baker's Appeal*, 109 Pa. St. 461. As to surrender of franchises, see §§ 433, 434.

for such alteration would be unconstitutional, in that it would impair the obligation of a contract,¹ or at least deprive some one of his "vested rights." Therefore, the state cannot alter the constitution of a corporation regarded simply as law, so as to affect any legal relations in which it has manifested itself.² But as to the corporators, the state cannot alter this constitution so as to affect legal relations not yet arisen, because on the accepting of the charter by the corporators the state is held impliedly to agree that it will not alter the charter as a law, and this implied agreement is the contract between the state and the corporation. Thus, the corporation acquires a right under the protection of the Federal Constitution, that the rules of law in its own constitution shall remain unaltered; *i. e.*, it acquires the right that acts in respect of the corporate enterprise, which bring the actors under the operation of rules of law contained in the constitution of the corporation, shall continue to have that effect; shall continue to bring the actors within the opera-

Contract
between
the state
and the cor-
poration.

¹ *E. g.* A state law passed after the execution of a mortgage, which declares that the equitable estate of the mortgagee shall not be extinguished for twelve months after a sale under a decree of chancery, and which prevents any sale unless two-thirds of the amount at which the property has been valued by appraisers shall be bid therefor, impairs the obligation of a contract and is void. *Bronson v. Kinzie*, 1 How. 311; acc. *McCracken v. Hayward*, 2 How. 608; compare *Curtis v. Whitney*, 13 Wall. 68; *Connecticut Mut. Life Ins. Co. v. Cushman*, 108 U. S. 51. A contract between a state and a party whereby he is to perform certain duties for a specific period for a stipulated compensation, is within the protection of the Federal Constitution. *Hall v. Wisconsin*, 103 U. S. 5; see *Davis v. Gray*, 16 Wall. 203; *Chicago, etc. Ry Co. v. United States*, 104 U. S. 680. A constitutional amendment providing that no tax shall be levied for certain state railway aid bonds, already negotiated, until the law levying the tax be submitted to a vote of the people, and be adopted by a majority of those voting, is void, as impairing the obligation of a contract. *State v. Young*, 29 Minn. 474. But a retroactive act validating contracts does not impair the obligation of them. *Canal Co. v. Vallette*, 21 How. 414; *Gross v. United States Mortgage Co.*, 108 U. S. 477; see § 325. Thus, a statute which, by repealing a usury law, validates a voidable contract, is constitutional. *Ewell v. Daggs*, 108 U. S. 143.

² *E. g.* The state could not abolish the personal liability of shareholders for corporate indebtedness so as to affect legal relations already subsisting between them and creditors of the corporation. *Hawthorne v. Calef*, 2 Wall. 10.

tion of those same rules of law and occasion the same legal relations.

Much confusion seems to have arisen from the omission of courts and law-writers to specify more definitely what the contract between the corporation and the state really is. It is said that the charter of a corporation is a contract between the corporation and the state. But it is clear that the terms and provisions of the charter are not the terms and provisions of a contract between the state and the corporation in the sense in which the terms and provisions of a written agreement between A. and B. are the terms and provisions of a contract between them. Ordinarily in a charter or enabling act the state does not purport to contract with the corporation nor the corporation with the state. The terms and provisions of the charter or enabling act are rather rules of law which will manifest themselves in legal relations among the incorporators, and between them and other persons contracting in respect of the corporate enterprise. The agreement on the part of the state is that it will not alter or repeal these rules of law.

Apply the ordinary definition of a (executory) contract—an agreement to do or not to do a particular thing—to a charter or enabling act, and it will appear that the state does not agree to do anything, except (impliedly) not to alter the charter or enabling act as a rule of law, and (impliedly) to enforce it as a rule of law. For instance, a statute authorizing the building of a toll-bridge over a navigable river by a corporation “with two suitable draws, which shall be at least thirty feet wide,” was held to constitute when accepted a contract between the state and the corporation, which the state could not constitutionally alter by a subsequent statute requiring the corporation to maintain larger draws.¹ It is apparent that the contract in this case between the corporation and the state was simply that the state would not repeal or modify the former statute. To be sure a state may make other and further contracts with a corporation; *e. g.*, it may agree not to permit a similar corporation to establish itself near the former.

One may well raise the question whether this implied con-

¹ *Commonwealth v. New Bedford Bridge*, 2 Gray, 339.

tract not to alter the constitution of a corporation would be held to exist, did the matter arise as *res nova* in regard to a general enabling statute. If the right to repeal were not reserved, presumably, under the authority of past decisions, courts would hold that the statute could not be repealed or changed so as to affect the right of existing corporations to continue to carry on their business as under the statute. But would courts so hold in regard to a statute sanctioning limited partnerships? Is there any implied contract between the state and a limited partnership any more than between the state and an ordinary firm? No citizen by acting under a statute any more than by acting under a rule of common law acquires a right that the statute shall remain unrepealed so that he may always act under it and be protected by its terms.¹ And why should there be held to exist an implied contract between the state and an ordinary business corporation any more than between the state and a limited partnership? Still, who to-day is rash enough to hint that the decision in the Dartmouth College Case was based on the false analogy between a grant of a franchise (*i. e.*, the passage of a special law), and the grant of property? As Justice Davis said in *The Binghamton Bridge*:² "Courts to-day are *estopped* from questioning the doctrine of the Dartmouth College Case."

§ 451. That the constitution of a corporation is law is more apparent in respect of corporations formed under general enabling statutes, while the characteristics of a contract appear more prominently where a special charter is granted by the state to the corporators.³

Enabling
acts and
special
charters.

¹ See *Munn v. Illinois*, 94 U. S. 113, opinion of Waite, C. J.

² 3 Wall. 51, 73.

³ A number of state constitutions prohibit the passage of special acts conferring corporate franchises. See *Atkinson v. Marietta*, etc. R. R. Co., 15 O. St. 21; *School District v. Insurance Co.*, 103 U. S. 707. But it is held such a prohibition does not prevent a legislature from extending by special act the duration of corporate

franchises. *Colton v. Mississippi*, etc. Boom Co., 22 Minn. 372; or from altering the charter of an existing corporation. *Attorney-General v. North America Life Ins. Co.*, 82 N. Y. 172; *St. Paul Fire, etc. Ins. Co. v. Allis*, 24 Minn. 75; or from changing the name of a corporation. *Wallace v. Loomis*, 97 U. S. 146. Compare *Southern Pac. R. R. Co. v. Orton*, 6 Sawyer, 157, 186.

The differences between an enabling statute and a charter are, however, mainly differences in form.¹ A charter as well as an enabling statute prescribes rules for conduct; the difference being that these rules in the case of a charter have a more limited application. And an enabling statute, as well as a charter, proffers terms and facilities of action which are accepted by the corporators by filing their articles of association; only in the case of an enabling statute the terms are offered to the citizens of the state at large, any sufficient number of whom may accept them and incorporate themselves by complying with them.²

§ 452. Accordingly, the constitution of a corporation being of a dual nature—a law embodying a contract—it follows that the relations between the state and the corporation are of two kinds: (a) relations such as exist between the lawgiver and the citizen, and (b) legal relations occasioned by contract.³ It will be convenient to discuss the latter first.

Two kinds of relations between the state and a corporation.

¹ Except that enabling statutes are almost universally subject to alteration and repeal, through express reservation of that power by the state; while many charters exist wherein that power is not reserved.

² A substantial compliance with the terms of an enabling act is necessary to form a corporation thereunder; *e. g.*, the filing of the certificate is essential. *Stowe v. Flagg*, 72 Ill. 397; *Bigelow v. Gregory*, 73 Ill. 197; *Harris v. McGregor*, 29 Cal. 124. And the articles of association must comply with the statute; see *Reed v. Richmond St. R. R.*, 50 Ind. 342; *People v. Selfridge*, 52 Cal. 331; *State v. Central Ohio Relief Ass'n*, 29 O. St. 399. Compare *In re Spring Valley Water Works*, 17 Cal. 132; *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546; *Mokelumne Hill M'g Co. v. Woodbury*, 14 Cal. 424, and §§ 148, 739.

³ Legal relations occasioned by con-

tract may subsist between the lawgiver and the citizen. "The government sustains two distinct relations to the railroad company, and in considering her rights under this statute it is important to keep them separate. The company is organized under, and owes its corporate existence to, an act of Congress. The government has all the rights which belong to any other government as a sovereign, and legislative power over this creature of that power. That this power should not be too much crippled by the doctrine that a charter is a contract, the eighteenth section declares that Congress may at any time, having due regard to the rights of the companies named therein, add to, alter, amend, or repeal the act. The power of Congress, therefore, in its sovereign and legislative capacity over this corporation is very great. The government, however, holds another very important relation, namely, that of contract. It has loaned to the

§ 453. That a grant from a state is a contract within the purview of Article I. section 10 of the Federal Constitution was decided by *Fletcher v. Peck*;¹ that the charter of a corporation is a grant and therefore a contract, was decided by *Dartmouth College v. Woodward*;² and that in respect of the constitutional provision against

A charter a contract. Outline of the doctrine.

company twenty-seven million dollars, and granted it on certain terms many million acres." *United States v. Union Pacific R. R. Co.*, 98 U. S. 569, 613. It is to be noticed, however, that the contractual relations referred to in this extract arose from a loan by the government to the company.

¹ 6 Cranch, 87. "Is the power of the legislature competent to the annihilation of such title, and to the resumption of the property held? The principle asserted is that one legislature is competent to repeal any act which a former legislature was competent to pass, and that one legislature cannot abridge the powers of a succeeding legislature. The correctness of this principle, so far as affects general legislation, can never be controverted. But if an act be done under a law, a succeeding legislature cannot undo it. The past cannot be recalled by the most absolute power. Conveyances have been made, those conveyances have vested legal estates, and if those estates may be seized by the sovereign authority, still that they originally vested is a fact, and cannot cease to be a fact.

"When, then, a law is in its nature a contract, when absolute rights have vested under that contract, a repeal of that law cannot divest those rights; and the act of annulling them, if legitimate, is rendered so by a power applicable to the case of every individual in the community. . . .

"What is a contract? Is a grant a contract? A contract is a compact between two or more parties, and is either executory or executed. An executory contract is one in which a party binds himself to do or not to do a particular thing; such was the law under which the conveyance was made by the governor. A contract executed is one in which the object of contract is performed; and this, says Blackstone, differs in nothing from a grant. The contract between Georgia and the purchasers was executed by the grant. A contract executed as well as executory contains obligations binding on the parties. A grant in its own nature amounts to an extinguishment of the right of the grantor, and implies a contract not to reassert that right. A party is therefore always estopped by its own grant. Since then, in fact, a grant is a contract executed, the obligation of which still continues, and since the constitution uses the general term 'contracts,' without distinguishing between those which are executory and those which are executed, it must be construed to comprehend the latter as well as the former. . . . It would be strange if a contract to convey was secured by the constitution, while an absolute conveyance remained unprotected." *Marshall, C. J.*, 6 Cranch, 135-7.

² 4 Wheaton, 518. "The objects for which a corporation is created are universally such as the government wishes

the enacting of a law by a state impairing the obligation of contracts, the grant is to be construed strictly in favor of the state, and as giving no rights against the public by implication, was decided by *The Charles River Bridge v. the Warren Bridge*.¹

to promote. They are deemed beneficial to the country; and this benefit constitutes the consideration, and in most cases the sole consideration of the grant." *Marshall, C. J.*, 4 *Wheaton*, p. 637. "The opinion of the court, after mature deliberation, is, that this is a contract, the obligation of which cannot be impaired without violating the constitution of the United States. This opinion appears to us equally supported by reason and by the former decisions of this court." *Ib.*, p. 650. *Accord*, *The Binghamton Bridge*, 3 *Wall*. 51, where, at p. 73, *Davis, J.*, says, giving the opinion of the court: "We have supposed, if anything was settled by an unbroken course of decisions in the Federal and state courts, it was that an act of incorporation was a contract between the state and the stockholders." It would be a work of supererogation to cite cases in support of the above proposition. Still the following may be referred to: *Planters' Bank v. Sharp*, 6 *How*. 301; *State Bank of Ohio v. Knoop*, 16 *How*. 369; *Bank of the State v. Bank of Cape Fear*, 13 *Ired. (N. C.) Law*, 75; *Jemison v. Planters' etc. Bank*, 23 *Ala.* 168; *Aurora, etc. Turnpike Co. v. Holthouse*, 7 *Ind.* 59; *Hamilton v. Keith*, 5 *Bush (Ky.)*, 458; *Regents of the University of Maryland v. Williams*, 9 *Gill & J.* 365; *Norris v. Trustees of Abington Academy*, 7 *Gill & J.* 7; *People v. Manhattan Co.*, 9 *Wend.* 351; *Commonwealth v. Cullen*, 13 *Pa. St.* 133; *State v. Noyes*, 47 *Me.* 189. *Contra*, *Mechanics and Traders' Bank v. Debolt*, 1 *Ohio St.* 591; *Toledo*

Bank v. Bond, *ib.* 622; *Skelly v. Jefferson Branch Bank*, 9 *Ohio St.* 606.

The legislature may alter the charter with the assent of all the corporators, *Smead v. Indianapolis, P. and C. R. R. Co.*, 11 *Ind.* 104.

In construing the charter contract between the corporation and the state, reference is also to be had to existing statutes. Thus, a charter granted the franchise to construct a toll-bridge; at the time, there existed a law forbidding the erection of one toll-bridge within three miles of another. *Held*, subsequent legislation permitting another toll-bridge within three miles of the first was unconstitutional. *Micou v. Tallassee Bridge Co.*, 47 *Ala.* 652; compare *The Binghamton Bridge*, 3 *Wall.* 51.

¹ 11 *Peters*, 420; see *Hartford Bridge Co. v. Union Ferry Co.*, 29 *Conn.* 210; *Fitch v. New Haven, New London, etc. R. R. Co.*, 30 *Conn.* 38; *Mills v. St. Clair County*, 8 *How.* 569; *Fanning v. Gregoire*, 16 *How.* 524; *Shorter v. Smith*, 9 *Ga.* 517; *Collins v. Sherman*, 31 *Miss.* 679; *Ruggles v. Illinois*, 108 *U. S.* 526; *Lake v. Virginia, etc. R. R. Co.*, 7 *Nev.* 294.

Where a state charters a turnpike company without expressly granting it any exclusive privileges, the state may constitutionally charter a railroad company to run its road by the side of the turnpike, to the damage of the latter. *Turnpike Co. v. The State*, 3 *Wall.* 210; *Lafayette Plank Road Co. v. New Albany, etc. R. R. Co.*, 13 *Ind.* 90;

These three cases outline the constitutional doctrines on this subject.

§ 454. The consideration moving from the corporators to the state, is either the supposed public benefit which the state or people acquires from the acts which are to be performed by the corporation; or the acting upon the terms of the charter by the corporation. Thus, the state acquires the right to enforce the application of the corporate property to the attainment of the objects of incorporation, at least in so far as the public is interested in their attainment. "There is an implied undertaking on the part of every corporation that it will render to the public, so far as it reasonably can, that service for which it was incorporated, and that it will not voluntarily disable itself to serve the purpose for which it was created."¹ And there is the further implied agreement on the part of the grantees to exercise their franchises within a reasonable time.² Accordingly, a mandamus will issue at the suit of the people of the state to compel a railroad company to operate its road³ or to erect suitable stations,⁴ or to build a drawbridge provided for in its charter.⁵

Consideration moving to the state. Its rights. *Mandamus.*

Bush v. Peru Bridge Co., 3 Ind. 21; *Tuckahoe Canal Co. v. Tuckahoe R. R. Co.*, 11 Leigh (Va.), 42; compare *Micou v. Tallassee Bridge Co.*, *ante*; similarly, to run alongside of a canal; *Illinois and M. Canal v. Chicago and R. I. R. R. Co.*, 14 Ill. 314, or one railroad to run parallel with a prior railroad between the same termini. *Connecting Ry. Co. v. Union Ry. Co.*, 108 Ill. 459.

The strict construction in favor of the state is especially exemplified in cases of granted immunity from taxation. See §§ 487-491; see *Wiggins Ferry Co. v. East St. Louis*, 107 U. S. 365.

¹ *Kenton County Court v. Bank Lick Turnpike Co.*, 10 Bush (Ky.), 529, 532. Compare *American Rapid Tele-*

graph Co. v. Connecticut Telephone Co., 49 Conn. 352; *Commonwealth v. Fitchburg R. R. Co.*, 12 Gray (Mass.), 180; *Gates v. Boston, etc. R. R. Co.*, 53 Conn. 333; *People's Gaslight Co. v. Chicago Gaslight Co.*, 20 Ill. App. 473.

² *Chincleclamouche Lumber Co. v. Commonwealth*, 100 Pa. St. 438.

³ *State v. Hartford and N. H. R. R. Co.*, 29 Conn. 538; see *People v. Albany and Vermont R. R. Co.*, 24 N. Y. 261.

⁴ *Railroad Commissioners v. Portland and Oxford C. R. R. Co.*, 63 Me. 269, where, at p. 278, Dickerson, J., said, giving the opinion of the court: "Railroad charters are contracts made by the legislature on behalf of every person interested in anything to be

⁵ *New Orleans M. and T. Ry. Co. v. Mississippi*, 112 U. S. 12.

§ 455. In a recent New York case,¹ where the complaint
 Railroads. alleged the failure of certain railroads to receive and
 transport freight (on account of a general freight
 handlers' strike), Chief Justice Davis said, giving the opinion
 of the court: "The question presented by this motion is one of
 signal importance. It is whether the people of the state can
 invoke the power of the courts to compel the exercise by rail-
 road companies of the most useful public functions with which
 they are clothed. . . . As bodies corporate, their owner-
 ship may be, and usually is, altogether private, belonging to
 the holders of their capital stock, and their management may
 be vested in such officers or agents as the stockholders and
 directors under the provisions of law may appoint. In this
 sense they are to be regarded as trading or private corporations,
 having in view the profit or advantage of the corporators. But
 these considerations are in no just sense in conflict with their

done under them. In consideration of the franchise they receive from the state, railroad companies agree to perform certain duties towards the public. The power of determining those duties and enforcing their performance is vested in the appropriate tribunals of the state. Being creatures of the law, intrusted with the exercise of sovereign powers to subserve public necessities and uses, railroad companies are bound to conduct their affairs in furtherance of the public objects of their creation." But in *People v. New York, L. E. and W. R. R. Co.*, 104 N. Y. 58, the court refused a mandamus to compel a railroad company to erect a station.

And a mandamus will issue at the suit of a private person to enforce a public duty not due to the government as such. *Union Pacific R. R. Co. v. Hall*, 91 U. S. 343, 355; *People v. Manhattan Gas Light Co.*, 45 Barb. 136; *State v. Telephone Co.*, 36 Ohio St. 296; *State v. Dayton and South-eastern R. R. Co.*, 36 Ohio St. 434;

State v. Paterson, Newark, and N. Y. R. R. Co., 43 N. J. Law, 505. Mandamus lies to compel a railroad company to deliver grain at a particular elevator. *Chicago and Northwestern R. R. Co. v. People*, 56 Ill. 365. A telephone company may be compelled by mandamus to furnish facilities to plaintiff. *Webster Telephone Case*, 17 Neb. 126. See also § 475.

¹ *People v. New York Central and Hudson River R. R. Co.*, 28 Hun, 543, 547. *Semble*, substantially overruling *People v. New York, Lake Erie, and Western R. R. Co.*, 22 Hun, 533.

In general mandamus lies where there is a clear legal right in the relator, a corresponding duty in the defendant, and a want of any other appropriate and specific remedy. *Borough of Easton v. Lehigh Water Co.*, 97 Pa. St. 554, 560. A corporation cannot be compelled by a mandamus to do what it has no right to do. See *American Rapid Telegraph Co. v. Connecticut Telephone Co.*, 49 Conn. 352.

obligations and duties to the public. The objects of their creation are from their very nature largely different from those of ordinary private and trading corporations. Railroads are in every essential quality public highways, created for public use, but permitted to be owned, controlled, and managed by private persons. But for this quality the railroads of the respondent could not lawfully exist. Their construction depended on the right of eminent domain which belongs to the state in its corporate capacity alone, and cannot be conferred except upon a 'public use.'

"The acceptance of such trusts on the part of a corporation by the express or implied contracts already referred to, makes it an agency of the state to perform public functions which might otherwise be devolved upon public officers. The analogy between such officials and railroad corporations in regard to their relations to the state is strong and clear, and so far as affects the construction and proper and efficient maintenance of their railroad will be questioned by no one. It is equally clear, we think, in regard to their duties as carriers of persons and property. This springs sharply out of the exclusive nature of their right to do these things. On other public highways every person may be his own carrier, or he may hire whomsoever he will to do that service. In such a case the carrier has not contracted with the state to assume the duty as a public trust, nor taken power to do it from the state, by becoming the special donee and depositary of a trust. A good reason may therefore be assigned why the state will not by mandamus enforce the performance of his contract by such a carrier. But the reason for such a rule altogether fails when the public highway is the exclusive property of a body corporate which alone has power to use it in a manner which of necessity requires that all management, control, and user, for the purposes of carriage, must be limited to itself, and which, as a condition of the franchise that grants such absolute and exclusive power over a user of a public highway, has contracted with the state to accept the duty of carrying all persons and property within the scope of its charter as a public trust.

"We cannot bring our minds to entertain a doubt that a rail-

road corporation is compellable by mandamus to exercise its duties as a carrier of freight and passengers, and that the power so to compel it rests equally firmly on the ground that that duty is a public trust, which having been conferred by the state, and accepted by the corporation, may be enforced for the public benefit, and also upon the contract between the corporation and the state expressed in its charter, or implied by the acceptance of the franchises, and also upon ground that the common right of all the people to travel and carry upon every public highway of the state has been changed by the legislature, for adequate reasons, in this special instance, into a corporate franchise to be exercised solely by a corporate body for the public benefit, to the exclusion of all other persons, whereby it has become the duty of the state to see to it that the franchise so put in trust be faithfully administered by the trustee." Accordingly, the court held that the fact that injured individuals may have private remedies for damages does not exclude the state from its remedy by mandamus, and that a peaceable strike of its freight handlers does not excuse a railroad company from operating its road and carrying freight.¹

§ 456. The right to enforce the application of the corporate property to the purposes of incorporation the state clearly would not have had but for the acceptance of the charter by the corporation. The state could not force individuals to apply their property without compensation to the building of a railroad, because such action would be against common right,² and

Through acceptance of the charter on the part of the corporation, the state acquires the

¹ A peculiarity of the rights acquired by the state through the contract with the corporation lies in the fact that the possessor of these rights, the state itself, enforces them. They are, to be sure, determined through a judicial proceeding, but it is the power of the state that enforces judicial proceedings. If the state cannot enforce its own laws, the assistance of the Federal government may be invoked under the Federal Constitution; but such

necessity would occur only in cases of extraordinary emergency.

² "It may well be doubted whether the nature of society and of government does not prescribe some limits to the legislative power; and if any be prescribed, where are they to be found if the property of an individual, fairly and honestly acquired, may be seized without compensation?" Marshall, C. J., in *Fletcher v. Peck*, 6 Cranch, 135. "We entertain an high opinion

because the Federal Constitution forbids a state to take private property without due process of law.¹ Clearly, if the state were absolutely sovereign, it could acquire no rights or further powers over a citizen through contract, or through the assumption of a duty, or the waiver of constitutional right on his part, for the state would, in such case, already have power to do whatever any citizen could agree that it should do.² But in truth, in no Anglo-Saxon community has there ever existed absolute sovereignty,³ any power so supreme or absolute that it

right to enforce the fulfilment of the corporate duties. Absolute sovereignty.

of the legislative authority; but we have never dreamt that Parliaments had any right to violate property." Burke, French Revolution. And Bracton said, centuries before, "Omnis nova constitutio futuris formam imponere debeat et non præteritis." De Leg., 4 fol. 228 a.

"And it appears on our own books," says Coke, "that in many cases the common law will controul acts of Parliament, and sometimes adjudge them to be utterly void; for when an act of Parliament is against common right and reason, or repugnant or impossible to be performed, the common law will controul it, and adjudge such act to be void." Bonham's Case, 8 Rep. 118 a, in which case instances are cited where statutes were declared null by courts. See also Calvin's Case, 7 Rep., 14 a.

"And what my Lord Coke says in Dr. Bonham's case in his 8 Co. is far from an extravagancy, for it is a very reasonable and true saying that if an act of Parliament should ordain that the same person should be party and judge, or, which is the same thing, judge in his own case, it would be a void act of Parliament." Holt, C. J., in City of London v. Wood, 12 Mod. 669, 687.

"Even an act of Parliament made against natural equity, as to make a man a judge in his own case, is void in itself, for *jura naturalia sunt immobilia*, and they are *leges legum*." Day v. Savage, Hobart, 87.

In the American system of government there exists no absolute power. "The theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere. The executive, the legislative, and the judicial branches of these governments are all of defined and limited powers. There are limitations on such power which grow out of the essential nature of all free governments. Implied reservations of individual rights, without which the social compact could not exist, and which are respected by all governments entitled to the name." Loan Association v. Topeka, 20 Wall. 655; acc. Parkersburg v. Brown, 106 U. S. 487. Compare License Cases, 5 How. 588; Ableman v. Booth, 21 How. 516; Tarble's Case, 13 Wall. 406; United States v. Cruikshank, 92 U. S. 542.

¹ Amendment XIV.

² See Austin, Province of Jurisprudence. Lecture VI.

³ If the learned reader will appreciate the truth of this remark, let him

could do anything not in itself impossible. Although it may be hard to conceive any body politic wherein there is not some force superior to all other forces, the fact, nevertheless, remains that there is no unqualified supreme power in any state.¹ And by this proposition no mere truism is meant, that there is no power in a state that can make two and two equal to five. The proposition means that there never exists unqualified political supremacy. The sum total of the physical force of a nation exists in the people thereof. But this sum total of physical force is far from constituting any unqualified political supremacy, because it is incapable of unqualified organization; incapable through its humanity, of unconditional subjection to any will. And as no man ever absolutely subjects himself to the common will, there can be no unqualified common will. Accordingly, it is impossible for any state to do all that a single being could, who possessed in himself the entire physical force of the members of the state. Never did there exist any political sovereignty so absolute that it might not wreck itself in attempting what it could not do.

There are certain things which men of any given race will not submit to, things which shock general notions of right and wrong, of justice and injustice, expediency and in expediency, however one may phrase it; and the result of action by government in disregard of these notions is revolution;² though government will rarely act in disregard of them; as it is itself part of the people to whom these notions are common. As said in the citation in the note, an act of Parliament against common equity is void, and these general notions of common equity and common right may well be called the *leges legum*.³

peruse Stubb's Constitutional History of England, which he will find the growth of English government traced by a master's hand. From that work may he learn how hardly a government acquires powers. Indeed the history of the English constitution, as well as the history of the development of our own system of government, exemplifies the fact that the early factor

in the development of political power is the necessity of becoming a community, and that the later factor in the same development, is the necessity of becoming a nation.

¹ The term "state" is not used here as meaning one of the United States.

² Witness our own Revolution.

³ *Day v. Savage*, Hobart, 87. See former notes to this section.

"I must beg leave to observe," says Burke, "that it is not only the invidious branch of taxation that will be resisted, but that no other given part of legislative rights can be exercised without regard to the general opinion of those who are to be governed. That general opinion is the vehicle and organ of legislative omnipotence. Without this, it may be a theory to entertain the mind, but it is nothing in the direction of affairs. The completeness of the legislative authority of Parliament over this kingdom is not questioned; and yet many things indubitably included in the abstract idea of that power, and which carry no absolute injustice in themselves, yet being contrary to the opinions and feelings of the people, can as little be exercised as if Parliament in that case had been possessed of no right at all. I see no abstract reason that can be given, why the same power which made and repealed the High Commission Court and the Star Chamber, might not revive them again; and these courts, warned by their former fate, might possibly exercise their powers with some degree of justice. But the madness would be as unquestionable as the competence of that Parliament which should attempt such things. . . . In effect to follow, not to force public inclination; to give a direction, a form, a technical dress, and a specific sanction to the general sense of the community is the true end of legislation."¹

§ 457. The state may also restrain the improper or illegal exercise of corporate powers;² and when a corporation fails to perform duties which it was incorporated to perform, and in which the public have an interest, or does acts which it is not authorized or is forbidden to do, the state may forfeit its franchises and dissolve

Right of the state to restrain an abuse of corporate powers. Forfeiture.

¹ Letter to the Sheriffs of Bristol on the affairs of America (1777).

² The attorney-general may maintain an information in equity to restrain a corporation possessing the right of eminent domain from any abuse or perversion of its powers that might create a public nuisance or endanger public interests. *Attorney-General v. Jamaica Pond Aqueduct*, 133 Mass. 361. By their attorney-

general the people may enjoin an attempted illegal consolidation. *People v. Boston, etc. Ry. Co.*, 12 Abb. N. C. (N. Y.) 230. The jurisdiction, however, of a court of equity is questionable, in the absence of special statutory enablement. See *Pixley v. Roanoke Nav. Co.*, 75 Va. 320; *Attorney-General v. Utica Ins. Co.*, 2 Johns. Ch. (N. Y.) 371.

the corporation by a proceeding or information, in the nature of a *quo warranto*,¹ for a grant of corporate franchises is always subject to the implied condition that they will not be abused.² The proper officer to file the information or make application for the writ is the attorney-general. In New York, for instance, the attorney-general may maintain an action upon his own information, or upon the complaint or relation of a private person, against one or more persons who act as a corporation within the state without being duly incorporated; or who exercise within the state any corporate rights, privileges, or franchises not granted to them by the law of the state.³

§ 458. It is a rule generally recognized, that a legislature cannot itself declare a forfeiture of the franchises of a corporation; for a forfeiture should be enforced through some judicial proceeding.⁴ But, where it is expressly provided in the charter of the corporation that unless certain things are done by the corporation within a certain time, the franchises of the corporation shall cease and become forfeited, it has been held that the legislature may declare its franchises forfeited on failure by the corporation to perform within the

¹ *People v. Utica Insurance Co.*, 15 Johns. 358; *People v. Pittsburgh R. R. Co.*, 53 Cal. 694; *Golden Rule v. People*, 118 Ill. 492. "In its relations to the government, and when the acts or neglects of a corporation, in violation of its charter or the general law, become the subject of public inquiry with a view to a forfeiture of its charter, the wilful acts and neglects of its officers are regarded as the acts and neglects of the corporation, and render the corporation liable to a judgment or decree of dissolution." Angell and Ames on Corp. § 310; see *Bank Commissioners v. Bank of Buffalo*, 6 Paige, 497; *Ward v. Sea Insurance Co.*, 7 Paige, 294; *Bank Commissioners v. James Bank*, 9 Paige, 457.

"To a writ of *quo warranto*, or an information in the nature of one, the defendant must either disclaim or jus-

tify, and the state is bound to show nothing." Angell and Ames on Corp. § 756; *State v. Vanderbilt*, 37 O. St. 591.

² *Chicago Life Ins. Co. v. Needles*, 113 U. S. 574. Compare *Chincel-clamouche Lumber Co. v. Commonwealth*, 100 Pa. St. 438.

³ Code of Civil Procedure, § 1948. It is competent for the legislature to confer on private parties the right to institute proceedings to forfeit a charter. *State v. Consolidation Coal Co.*, 46 Md. 1.

⁴ *Bruffett v. Great Western R. R. Co.*, 25 Ill. 353; and a court of law is the proper court to determine the question of the forfeiture. *President, Managers, etc. v. Trenton City Bridge Co.*, 13 N. J. Eq. 46; *Attorney-General v. Utica Ins. Co.*, 2 Johns. Ch. (N. Y.) 371.

time specified, and may grant them to another corporation.¹ Nevertheless, in accordance with the fundamental principles of our system of government, while it is the province of the legislature to make laws, it is the province of the courts to say whether the laws have been observed or violated; and accordingly it would seem proper that a judicial tribunal should determine whether or not that condition of fact exists which the legislature has declared shall forfeit the franchises of a corporation.²

§ 459. When a corporation is found guilty of acts which by statute are declared to be a cause of forfeiture of its franchises, a court has no discretion to refuse judgment of ouster therefrom;³ but in other cases a court has discretion in the matter to refuse a judgment of ouster if in the opinion of the court the interests of the public do not call for it;⁴ for it is generally held that the state or the public should have some real interest in procuring a forfeiture of corporate franchises.⁵ The following have been held grounds of forfeiture: a constant and wilful violation by a bank of the fundamental articles of its charter, by discounting paper at higher rates than

Grounds of
forfeiture.

¹ *Oakland R. R. Co. v. Oakland, etc.* R. R. Co., 45 Cal. 365. See *Matter of Brooklyn, Winfield, etc. R. R. Co.*, 75 N. Y. 335; *Brooklyn Steam Transit Co. v. Brooklyn*, 78 N. Y. 524; *Farnsworth v. Minnesota and Pacific R. R. Co.*, 92 U. S. 49; *Mobile and O. R. R. Co. v. State*, 29 Ala. 573.

² See *Flint, etc. Plank Road Co. v. Woodhull*, 25 Mich. 99. A charter provided that unless a certain road was begun and completed within specified periods "this corporation shall cease and this act shall be void." It was held that this was not intended to declare a forfeiture but a cause of forfeiture, and that judicial action was necessary. *Vermont and C. R. R. Co. v. Vermont Central R. R. Co.*, 34 Vt. 2.

³ *State v. Building Association*, 35 O. St. 258.

⁴ *State v. Building Association*, 35 Ohio St. 258; *State v. Essex Bank*, 8 Vt. 489. See *People v. North Chicago Ry. Co.*, 88 Ill. 537.

⁵ *Harris v. Mississippi Valley, etc. R. R. Co.*, 51 Miss. 602; see *King v. Howell, Hardwicke's Cases*, 235; *Ibbotson's Case*, ib. 248; *Attorney-General v. Tudor Ice Co.*, 104 Mass. 239; *People v. Bogart*, 45 Cal. 73; *Commonwealth v. Arrison*, 15 S. & R. 127; *Commonwealth v. Union Fire and Marine Ins. Co.*, 5 Mass. 230. Compare *State v. Rio Grande R. R. Co.*, 41 Tex. 217. As to when a state has such an interest as will entitle it to move in the Federal courts against a corporation, see *State of Pennsylvania v. Wheeling, etc. Bridge Co.*, 13 How. 518.

those prescribed;¹ that the principal office of the corporation and its books and records are kept out of the state, and that none of its general officers reside within the state;² a sale by a turnpike company of a portion of its road, and its neglect thereafter to keep that portion in repair;³ non-compliance by a turnpike company with the requirements of its act in regard to the construction of its road;⁴ an unauthorized assumption by an insurance company of banking privileges;⁵ and, in general, any substantial non-compliance on the part of a corporation, in respect of its organization, with the provisions of its enabling act.⁶ The following have been held not to be grounds of forfeiture: insolvency of the corporation;⁷ the mere omission of a corporation to use its powers;⁸ that the corporation has obtained a charter from another state.⁹

¹ *Commonwealth v. Commercial Bank*, 28 Pa. St. 383; see *Commercial Bank v. State of Mississippi*, 14 Miss. 599.

² *State v. Milwaukee L. S. and W. R'y Co.*, 45 Wis. 579.

³ *State v. Pawtuxet Turnpike Co.*, 8 R. I. 182.

⁴ *People v. Kingston, etc. Turnpike Co.*, 23 Wend. 193; see *People v. Fishkill, etc. Plank Road Co.*, 27 Barb. 445.

⁵ *People v. Utica Ins Co.*, 15 Johns. 358.

⁶ *State v. Central Ohio Relief Association*, 29 Ohio St. 399; *State v. Vanderbilt*, 37 Ohio St. 591; *State v. Hazleton, etc. Ry. Co.*, 40 O. St. 504; *People v. Cheeseman*, 7 Col. 376. Where the statute requires a specified amount to be subscribed for a railroad company, the subscription must be made in good faith by persons having a reasonable expectation of being able to pay; or the state may forfeit the franchises, and is not concluded by the articles of incorporation filed, showing that the requisite amount

has been subscribed for. *Holman v. State*, 105 Ind. 569.

Substantial compliance with conditions attached to a grant of corporate franchises is all that is necessary. Thus, where a corporation is required by statute to have paid up one-half its capital stock "in lawful money of the United States," it suffices if the corporation has received as payment property whose market value exceeds the par value of the stock. *State v. Wood*, 84 Mo. 378 (quære?).

⁷ *State v. Bailey*, 16 Ind. 46; but see *State v. Real Estate Bank*, 5 Ark. 595; *Commercial Bank of Natchez v. State*, 6 Sm. & M. (Miss.) 617.

⁸ *Attorney-General v. Bank of Niagara, Hopkins Ch. (N. Y.)* 354; see *State v. Barron*, 58 N. H. 370.

⁹ *Commonwealth v. Pittsburgh and Connellsville R. R. Co.*, 58 Pa. St. 26. An unauthorized consolidation of two turnpike companies, entered into in good faith, but subsequently declared void, is not a ground of forfeiture of the original charters; and the property reverts to the two original

§ 460. Grounds of forfeiture cannot be taken advantage of or enforced collaterally or incidentally, or in any other mode than by a direct proceeding for that purpose against the corporation.¹ And the state may waive a forfeiture by express legislation to that effect or by legislation recognizing the existence of the corporation.² But mere lapse of time is not a bar to the enforcement of a forfeiture by the state.³ “Duties required by

Grounds of forfeiture not to be taken advantage of collaterally. Waiver.

companies. *State v. Crawfordsville T. P. Co.*, 102 Ind. 283; *Crawfordsville, etc. T. P. Co. v. State*, ib. 435.

¹ *Duke v. Cahawba Navigation Co.*, 16 Ala. 372; *Briggs v. Cape Cod Ship Canal Co.*, 137 Mass. 71; see *Cowell v. Springs Co.*, 100 U. S. 55; *Bacon v. Robertson*, 18 How. 480; and cases in the following note. Except where the act or omission produces in itself a forfeiture; *Brooklyn Steam Transit Co. v. Brooklyn*, 78 N. Y. 524; and indeed this last is taking advantage of a forfeiture, not a ground of forfeiture. See, generally, §§ 145 *et seq.*

² *Davis v. Gray*, 16 Wall. 203; *State v. Mississippi, etc. R. R. Co.*, 20 Ark. 495; *People v. Manhattan Co.*, 9 Wend. 351; *In re New York Elevated R. R. Co.*, 70 N. Y. 327; *Central, etc. Road Co. v. People*, 5 Col. 39, 46; *People v. Ottawa Hydraulic Co.*, 115 Ill. 281. A statute waiving a forfeiture of corporate rights confers no new rights upon the corporation, but is simply a surrender or waiver by the sovereign of its right to claim the forfeiture. So a statute to extend the time within which corporate rights may be exercised, gives no new substantial rights. *In re New York Elevated R. R. Co.*, *supra*. Compare *Matter of Brooklyn W., etc. R. R. Co.*, 75 N. Y. 335. Legislative waiver of a forfeiture, by acts of

recognition, cures defects in the original organization of the corporation. *Bashor v. Dressel*, 34 Md. 503; *Kanawha Coal Co. v. Kanawha and Ohio Coal Co.*, 7 Blatchf. 391; see also *Attorney-General v. Petersburg, etc. R. R. Co.*, 6 Ired. L. 470; *State v. Fourth N. H. Turnpike*, 15 N. H. 162.

³ *State v. Pawtuxet Turnpike Co.*, 8 R. I. 521. This case may seem not to accord with the English cases, which hold that informations in the nature of a *quo warranto* cannot be maintained against a person who has enjoyed a corporate office or the privilege of being a corporator, for a number of years. The number of years was first fixed at twenty, and subsequently reduced to six. *Winchelsea Causes*, 4 Burr. 1962, 2022, 2121; *Rex v. Dicken*, 4 T. R. (Durn. & East), 282; *Rex v. Peacock*, ib. 684; but Lord Mansfield, who decided the *Winchelsea Causes*, intimated that this rule did not apply where the action was brought by the crown; as he said: “Indeed no length of usurpation shall affect the crown. *Nullum tempus occurrit regi* . . . the crown may still bring a *quo warranto*.” *Rex v. Wardroper*, 4 Burr. 1965.

In regard to the questions under discussion in the last few pages, see generally the chapters in Angell and Ames on Corp. on “Mandamus” and

the act of incorporation are in the nature of conditions annexed to the grant of the franchise. Such conditions may be precedent or subsequent, and like other conditions may be released by the power granting, or a new grant may be made free from any limitation or condition by the same power. In accordance with well-settled rules, the intent to waive or release conditions, or to make a new grant, must be expressly declared or plainly to be inferred from some act of the granting power."¹

§ 461. On the other hand, what are the rights of the corporation against the state, occasioned by the contract between them? In brief, that the state shall pass no law changing the legal effect of acts in respect of the corporate enterprise; *i. e.*, that the state shall not materially alter the constitution of the corporation (unless it has reserved the right to do so) except in

Rights of the corporation against the state arising from the contract.

"Quo Warranto;" see also *State v. Southern Pacific R. R. Co.*, 24 Tex. 80; *Danville, etc. Plank Road Co. v. State*, 16 Ind. 456; *State v. Council Bluffs Ferry Co.*, 11 Neb. 354; *People v. Improvement Co.*, 103 Ill. 491. An action in the nature of a *quo warranto* is in effect a civil not a criminal action. *Ames v. Kansas*, 111 U. S. 449. When the suit is brought for usurping powers not granted, it should be against the corporation and not against an officer. *Smith v. The State*, 21 Ark. 294. Quo warranto will not lie against the members of the corporation alone; the corporation must be a party. *State v. Taylor*, 25 Ohio St. 280.

As to the mode in which proceedings or informations in the nature of *quo warranto* are carried on, little of general value can be said here. It is a matter of practice, and usually of local or statutory practice. When a statute declares how corporate franchises shall be forfeited, this supercedes the common law mode. *Green v. St. Albans Trust Co.*, 57 Vt. 340.

As to necessary averments in the pleadings, see *Territory v. Virginia Road Co.*, 2 Montana, 96; *Chicago City Ry. Co. v. People*, 73 Ill. 541; *Attorney-General v. Chicago, etc. R. R. Co.*, 112 Ill. 520. When to a *quo warranto* a charter regular on its face is pleaded, it is competent for the relator to show by way of replication, that the charter has been forfeited by the act of the defendant, or that the charter does not confer upon the defendant the particular franchise in dispute. *State of Ohio v. Pennsylvania and Ohio Canal Co.*, 23 Ohio St. 121; compare *State v. Cincinnati*, 23 Ohio St. 445. In proceedings for dissolution of a railroad company and the forfeiture of its franchises, one who has taken a lease of a portion of its road for the term of its corporate existence, should be made a party (under the Code of Civil Procedure). *People v. Albany and Vermont R. R. Co.*, 77 N. Y. 232.

¹ *State v. Godwinsville, etc. Road Co.*, 44 N. J. L. 496, 499, opinion of Ct. per Magie, J.

the exercise of powers which the state cannot alienate or restrict itself in the exercise of. To be sure, the corporation may have other rights against the state occasioned by contract, if the state makes any special contract with it; as for instance that the corporate property shall be taxed only at a certain rate.¹ And this special contract may be so entered into as to remain irrevocable by the state, although the state has reserved the general right to alter and repeal the enabling statute or charter of the corporation.² But ordinarily the only contract between the state and the corporation is the implied one that the state will not alter the corporate constitution.

Of what law are these rights a manifestation? The Constitution of the United States, and especially its provisions that no state shall pass a law impairing the obligation of contracts, nor shall deprive any one of his property without due process of law. Accordingly, the power sanctioning the rights of the corporation against the state differs from that whereby the rights of the state against the corporation are enforced.³

§ 462. In what manner are the rights of the corporation against the state enforced? Here a peculiarity in this con-

¹ See §§ 488-491. So a special monopoly may be granted in such a way as to constitute a contract between the corporation and the state; *e. g.*, an enactment by a state in incorporating a company to build a toll bridge, that it should not be lawful for any person to erect any bridge within two miles of the said bridge, is an inviolable contract between the corporation and the state; and this though the charter of the corporation is without limit as to duration. *The Binghamton Bridge*, 3 Wall. 51; *Bridge Company v. Hoboken Land and Improvement Co.*, 13 N. J. Eq. 81, affirmed under the name of *Bridge Proprietors v. Hoboken Co.*, 1 Wall. 116. Compare, however, as to granting a special privilege to a corporation, *Gordon v. Winchester Building Ass'n*, 12 Bush (Ky), 110.

² See *New Jersey v. Yard*, 95 U. S. 104; and compare *University v. People*, 99 U. S. 309.

³ These two powers differ at least in their immediate source, the one being the power of the state, the other the power of the United States. But ultimately these two powers may become united; for, if the power of a state is insufficient, it will be supported by that of the United States; and the power of the United States is but the power of the people of all the states. The states are part and parcel of a nation, of which the Federal government exercises some of the powers. Compare *License Cases*, 5 How. 588; *Ableman v. Booth*, 21 How. 516; *Tarble's Case*, 13 Wall. 406; *United States v. Cruikshank*, 92 U. S. 542.

tract is encountered; for these rights often can be enforced only negatively as it were; and this on account of the inability of private individuals or incorporated bodies to sue a state or enforce a judgment against it.¹

Accordingly, the corporation can defend its rights, not through a suit brought directly against the state, but by an action against any one acting, pursuant to the unconstitutional state law, in violation of the rights of the corporation. To such a person, whether acting as agent of the state, or as a private individual, the unconstitutional state law, being void, will be no protection. And a state officer may be enjoined from executing a state law in conflict with the Constitution or laws of the United States.²

A late decision in regard to the right of an individual to sue the officers and agents of the *Federal* government, is *United States v. Lee*.³ There the defendants, making no claim as indi-

¹ Where a state provides for a suit against itself in its own courts, a subsequent statute nullifying such provision cannot impair the obligation of a contract, because there never was any power to enforce such suit in the court, and so the provision was no remedy in the legal sense of the term. *Railroad Co. v. Tennessee*, 101 U. S. 337; *Railroad Co. v. Alabama*, 101 U. S. 832; see *Beers v. Arkansas*, 20 How. 527. And one state cannot sue another state in the United States Supreme Court when the former is merely the assignee, for the purposes of bringing suit, of debts owing by the latter state to citizens of the former state. *New Hampshire v. Louisiana*, 108 U. S. 76.

A state, without its consent, cannot be sued by an individual; and a court may not substitute its own discretion for that of executive officers in matters belonging to the proper jurisdiction of the latter. But when a plain official duty, requiring no exercise of discretion, is to be performed, and performance is refused, any person who will

sustain personal injury by such refusal may have a *mandamus* to compel its performance; and when such duty is threatened to be violated by some positive official act, any person who will sustain personal injury thereby, for which adequate compensation cannot be had at law, may have an injunction to prevent it. *Board of Liquidation v. McComb*, 92 U. S. 531; compare *Louisiana v. Jumel*, 107 U. S. 711, *infra*. *

A state waives its immunity from suit by appearing and intervening as a party defendant in a suit brought in a Federal court. *Clark v. Barnard*, 108 U. S. 436.

² *Davis v. Gray*, 16 Wall. 203. In this case the receiver of a railroad company restrained by injunction the governor and certain other officers of the state of Texas from issuing patents for lands which had been granted to the company. *Davis v. Gray* was questioned in *Cunningham v. Macon and Brunswick R. R. Co.*, 109 U. S. 446.

³ 106 U. S. 196.

viduals, held as agents for the Federal government by a title arising from a defective tax sale, lands which the government had converted into a national cemetery. The defendants asserted, and it was asserted by the attorney-general on behalf of the United States, that, though it had been ascertained by a verdict of a jury, in which was no error, that the plaintiff had the title to the land in controversy, and that what was set up on behalf of the United States was no title at all, the court could render no judgment in favor of the plaintiff against the defendants in the action, because the latter held the property as officers and agents of the United States, and the property was appropriated to lawful public uses.

This proposition, say the majority of the court through Justice Miller, rests on the principle that the United States cannot be lawfully sued without its consent in any case, and that no action can be maintained against any individual without such consent, where the judgment must depend on the right of the United States to property held by such persons as officers or agents for the government. "The first branch of this proposition is conceded to be the established law of this country and of this court at the present day; the second, as a necessary or proper deduction from the first, is denied."¹ "The doctrine [that the United States or a State cannot be sued] if not absolutely limited to cases in which the United States are made defendants by name, is not permitted to interfere with the judicial enforcement of the established rights of plaintiffs when the United States is not a necessary party to the suit."² When a citizen in a court "of competent jurisdiction has established his right to property, there is no reason why deference to any person, natural or artificial, not even the United States, should prevent him from using the means which the law gives him for the protection and enforcement of that right."³ Then Justice Miller, after examining numerous cases, continues: "This examination of the cases in this court establishes clearly this result, that the proposition that when an individual is sued in regard to property which he holds as an

¹ 106 U. S. 204.

² 106 U. S. 208.

³ 106 U. S. 207.

officer or agent of the United States, his possession cannot be disturbed when that fact is brought to the attention of the court, has been overruled and denied in every case where it has been necessary to decide it.”¹ And the court added, that it made no difference that the property was devoted to a public use; as, indeed, such an objection would be repugnant to the fifth amendment to the Constitution, that no person shall be deprived of property without due process of law and just compensation. “Courts of justice are established, not only to decide upon the controverted rights of the citizens as against each other, but also upon rights in controversy between them and the government.”²

Justice Gray (with whom concurred Justices Waite, Bradley, and Woods) dissented, saying: “The sovereign is not liable to be sued in any judicial tribunal without its consent. The sovereign cannot hold property except by agents. To maintain an action for the recovery of the possession of property held by the sovereign through its agents, not claiming any right or title in themselves, but only as the representatives of the sovereign and in its behalf, is to maintain an action to recover possession of the property against the sovereign; and to invade such possession of the agents, by execution or other judicial process, is to invade the possession of the sovereign, and to disregard the fundamental maxim that the sovereign cannot be sued.”³ “The view in which this court appears constantly to have acted, which reconciles all its decisions, and is in accordance with the English authorities, is this: the objection to the exercise of jurisdiction over the sovereign or his property, in an action in which he is not a party to the record, is in the nature of a personal objection, which, if not suggested by the sovereign, may be presumed not to be intended to be insisted upon. . . . If property is in the possession of the defendants and not of the sovereign, an informal suggestion that it belongs to the sovereign will not defeat the action. But if the sovereign in proper form, and by sufficient proof, makes known to the court that he insists upon his exemption from suit, and that the property sued

¹ 106 U. S. 215.

³ 106 U. S. 226.

² 106 U. S. 220.

for is held by the nominal defendants exclusively for him and in his behalf as public property, the right of the plaintiff to prosecute the suit, and the authority of the court to exercise jurisdiction over it cease, and all further proceedings must be stayed.”¹ The reasoning in this case applies to suits brought against state officers.

In a still later case, however, the Supreme Court held that the creditors of a state, although their rights against it were secured by a clear contract, could not compel state officers to carry out the provisions of a statute, securing the rights of creditors, when the state, by an amendment to its constitution, had undertaken to prohibit its officers from acting under the statute, and when the court, if it required the officer to proceed, could not protect him with a judgment to which the state was a party.² “The court, when a state cannot be sued, cannot set up its jurisdiction over the officers in charge of the public moneys, so as to control them, as against the political power, in their administration of the finances of the state.”³ This decision pointed towards the proposition which the Supreme Court has finally declared; that whenever, in order to enable a court to grant the relief sought, it appears that a state is an indispensable party to the suit, the court has no jurisdiction.⁴

§ 463. Here must be noticed further and important limitations on the rights, which a corporation can acquire through its contract with the state, arising from limitations on the powers of the state legislatures. For the purposes of government, except as its powers are restricted by the Federal Constitution, a state may, perhaps, be regarded as sovereign. But the legislature of the state is not the state, and its powers are

Limitations
on the
rights
acquirable
by the
corpora-
tion
against
the state
through
contract.

¹ 106 U. S. 249.

³ 107 U. S. 728.

² *Louisiana v. Jumel*, 107 U. S. 711, distinguishing *United States v. Lee*, *supra*. See also *In re Ayers*, 123 U. S. 443. Compare *Board of Public Works v. Gaunt*, 76 Va. 455; *United States Bank v. Planters' Bank*, 9 Wheat. 904; *Bank of Kentucky v. Wister*, 2 Pet. 318.

⁴ *Cunningham v. Macon, etc. R. R. Co.*, 109 U. S. 446.¹ When a state begins suit against a person or corporation, the defendant may set off, but cannot have judgment over, in absence of a statute authorizing it. *Commonwealth v. Owensboro, etc. R. R. Co.*, 81 Ky. 572.

restricted (a) by the state constitution, and (b) by certain doctrines of constitutional law.

§ 464. If the state constitution provides that the power to alter, amend, and repeal shall always be reserved to the state in enabling statutes or in charters of incorporation, the legislature cannot act in violation of this provision; it cannot contract with the corporation not to change the corporate constitution.¹ Such a contract would be void, for constitutional provisions are imperative. Likewise, if the state constitution provides that railroad corporations shall not be created by special charter, a special charter, if granted by the state legislature, will be void, and the corporation will acquire no rights therefrom.²

It was said that the power of the state legislature is *restricted* by the state constitution. The phrase seems proper, for, unlike the Constitution of the United States, state constitutions are restrictive or regulative, rather than enabling in their general nature.³ Some special power or capacity of action may be granted to the legislature by the state constitution; but ordinarily legislatures are held to possess all the powers of the state

¹ Spring Valley Water Works v. Schottler, 110 U. S. 347, 355. When a reservation to the legislature of the power to revoke charters (or repeal enabling statutes), is contained in the constitution of a state, a charter is subject to this power, though not expressly made so. Spring Valley Water Works v. Schottler, 110 U. S. 347, 352; Delaware R. R. Co. v. Tharp, 5 Har. (Del.) 454; State v. Person, 32 N. J. L. 134; Griffin v. Kentucky Ins. Co., 3 Bush (Ky.), 592; so when the reservation is contained in some statute of general application. State v. Commissioner of Railroad Taxation, 37 N. J. L. 228.

² See Ames v. Lake Superior and Mississippi R. R. Co., 21 Minn. 241.

³ See Davis v. State, 68 Ala. 58; Dorman v. State, 34 Ala. 216, 236; Lynn v. Polk, 21 Am. Law Reg. N. S.

321, 326; People v. Draper, 15 N. Y. 532; Thorpe v. Rutland and Burlington R. R. Co., 27 Vt. 140; Sawyer v. City of Alton, 4 Ill. 127; Winch v. Tobin, 107 Ill. 212; Concord R. R. Co. v. Greely, 17 N. H. 47; State v. Nashville R. R. Co., 12 Lea (Tenn.), 583. Still the words of Judge Story in a dissenting opinion are worthy of attention. "But the legislature of Massachusetts is . . . in no just sense the sovereign of the state. The sovereignty belongs to the people of the state in their original character as an independent community; and the legislature possesses those attributes of sovereignty, and those only which have been delegated to it by the people of the state under its constitution." Charles River Bridge v. Warren Bridge, 11 Pet. 644.

except as restricted by the state constitution or by certain doctrines of constitutional law which may now be considered.

§ 465. There are certain powers necessary to the welfare, if not to the existence of the state as a self-governing community, and to justify the doctrine that these powers override all private rights, one need not look beyond the maxim, *Salus populi suprema lex*. The powers themselves fall under the general heads of eminent domain and what is loosely called the "police power" of the state.¹ It is a well-known doctrine of constitutional law that these powers cannot be granted away or abridged by one legislature so as in any way to bind its successors or even itself.² Consequently, the power to alter the rights of a corporation through the exercise of the right of eminent domain or the police power, and to take its property for public purposes, can never be surrendered by the legislature; any law or charter purporting to surrender it would in that respect be void. Therefore, taking the property of a corporation by the exercise of the power of eminent domain or of the police power can never impair the obligation of a contract, as these powers must in all cases be held to have been reserved to the legislature.³

Other restrictions on legislative powers.

§ 466. The legislature of the state, however, as before remarked, is not the state, and although the legislature cannot surrender the eminent domain or the police power of the state, it does not follow that the ultimate power of the state cannot do so. This ultimate power exists in a majority of the people of the state, and at first sight it would seem competent for them to do any political act which the Federal Constitution does not forbid the states to do. Accordingly, would it not be competent for the people by direct vote to surrender the right

¹ A discussion of the extent of these powers comes properly in a subsequent part of this chapter. §§ 470 *et seq.*

² "When the existence of a particular power in the government is recognized on the ground of necessity, no delegation of the legislative power by the people can be held to vest authority in the department which holds it in trust to bargain away such

power or to so tie up the hands of the government as to preclude its repeated exercise as often and under such circumstances as the needs of government may require." Cooley, Cons. Lim., p. 525.

³ See Twenty-second Street, *In re*, 102 Pa. St. 108; Philadelphia Passenger Ry. Co.'s Appeal, 102 Pa. St. 123.

of eminent domain as to the property of any given corporation? If so, and such corporation accepted a charter with such provision in it, would not that acceptance create a contract the obligation of which would be impaired by the exercise as to any property of that corporation of the power of eminent domain? These are questions of theoretical interest mainly. No partial surrender, it is thought, of its right to exercise its eminent domain has ever been made by a state, and such a surrender would never be implied. Whether the courts would hold such a surrender to be a valid contract, and as such within the protection of the Federal Constitution; or whether they would hold that, as states are integral parts of the United States, the Federal Constitution cannot sanction an act which might tend towards the disintegration or extinction of one of these integral parts remains an open question.

§ 467. A word may be added here in regard to corporations organized under authority from Congress. Although the constitutional provision against passing a law impairing the obligation of contracts does not apply to Congress, the prohibition against depriving any one of his property without due process of law and just compensation does; and as rights which have already vested under a contract are held to be property, Congress seems nearly as restricted as if the provision against passing a law impairing the obligation of contracts applied to it.¹ It will be seen, however, that any rights of a corporation against the United States would lack any sanction except the comity of the government, which, strictly speaking, is no sanction.²

§ 468. Questions whether or not particular state statutes, or particular acts done on behalf of a state, impair the obligation of any contract between a state and a corporation, come up properly for discussion in the following pages of this chapter, in connection with the

¹ *County of Cass v. Morrison*, 28 Minn. 257; see *Chicago, etc. R'y Co. v. United States*, 104 U. S. 680; and, for the construction of a contract between the United States and a corporation, see *Lake Superior and Mississippi R. R. Co. v. U. S.*, 93 U. S. 442.

² Compare generally *United States v. Lee*, 106 U. S. 196, and *Louisiana v. Jumel*, 107 U. S. 711.

topics of eminent domain, police power, taxation, and the right which a state may reserve to alter and amend the constitution of a corporation. Questions of this character are often decided in the Federal courts; and as the final decision, whether the obligation of a contract is impaired by a state law, rests with the Supreme Court of the United States,¹ the utterances of that court are of universal authority.

In construing the statutes of a state, the Federal Supreme Court will follow as far as may be the courts of the state whose statute it is construing;² but when the highest court of a state has held repeatedly that certain state statutes are valid, and when rights have vested under them, the Federal Supreme Court will not follow in construing such statutes any oscillations of the state court; at least when the Supreme Court is

¹ Where a party to a suit sets up that under one statute a state made a contract with him, and that by a subsequent statute it violated the contract, and the highest court of law or equity of the state has held the subsequent act to be a valid act, and decreed accordingly, the Supreme Court of the United States has jurisdiction under sec. 25 of the Judiciary Act. *The Binghamton Bridge*, 3 Wall. 51. And when a state statute creates a contract, and a subsequent statute is alleged to impair the obligation of that contract, and the highest court of law or equity in the state construes the first statute in such a manner that the second statute does *not* impair the contract, whereby the second statute remains valid under the United States Constitution, the Federal Supreme Court may pass on the decision. *Bridge Proprietors v. Hoboken Co.*, 1 Wall. 116. The Federal question relied on must have been raised on the trial in the state court. *Susquehanna Boom Co. v. West Branch Boom Co.*, 110 U. S. 57; *Brown v. Colorado*,

106 U. S. 95. The question whether a state may tax the franchises of a corporation derived from acts of Congress is removable to the Federal courts. *Southern Pacific R. Co. v. California*, 118 U. S. 109.

The constitution of a state is a "law" within the meaning of the clause in the Federal Constitution which forbids a state to pass a law impairing the obligation of contracts. *Railroad Co. v. McClure*, 10 Wall. 511.

² See *Wright v. Nagle*, 101 U. S. 791; *Secombe v. Railroad Co.*, 23 Wall. 108; but compare *Burgess v. Seligman*, 107 U. S. 20; see also *Beauregard v. New Orleans*, 18 How. 497, 502; *Bank of Hamilton v. Dudley's Lessee*, 2 Pet. 492, 524; *Elmendorf v. Taylor*, 10 Wheat. 152, 159; *Green v. Neal's Lessee*, 6 Pet. 291, 298. A decision by a state court that a statute of the state is in accordance with the state constitution binds the Federal courts. *Railroad Co. v. Georgia*, 98 U. S. 359.

deciding upon the legal effect of transactions taking place before the change in state judicial opinion had transpired.¹

§ 469. We now come to the relations between the state and the corporation other than the legal relations occasioned by the contract between them; to relations, that is, existing between the lawgiver as such and citizens. Reverting for an instant to the distinction before mentioned between the state considered as the ultimate political power thereof and the state legislature, it may be added that, though the powers of the legislature are more restricted than those of the state, still the legislature for ordinary purposes may be regarded as the state itself; and for the purposes of the following discussion, except as restrained by the state and Federal constitutions, and by the constitutional doctrines before referred to, the power of the state legislature over corporations may be regarded as unlimited in law; for persons interested in a corporate enterprise are, in respect of the same, subject to the laws of the state just as in all other respects.

§ 469 a. The political powers possessed by the Federal and state governments over corporations may be grouped under the general heads of police power, power to tax, and eminent domain. These three powers have their common source in the function of government to provide for the welfare of the people. Their distinguishing characteristics may be thus formulated.

By virtue of its police power the state regulates the use of property, but takes nothing.

By virtue of its power to tax, the state, according to a ratio proportioned as evenly and justly as may be, takes property for public uses without making direct compensation.²

¹ *Gelpcke v. City of Dubuque*, 1 Wall. 175; *Havemeyer v. Iowa County*, 3 Wall. 294; see *Olcott v. Supervisors*, 16 Wall. 678; *Douglass v. Pike County*, 101 U. S. 677. But the Federal courts will not follow a state court in deciding upon questions of general commercial law, not depending on local usage or statutes. *Swift v. Tyson*, 16 Pet. 1; *Railroad Co. v. National Bank*, 102 U. S. 14; nor, of course, in deciding whether a state statute conflicts with the Federal Constitution. *Jefferson Branch Bank v. Skelly*, 1 Black, 436. See § 318.

² There would often be manifest injustice in subjecting the whole property of a city or of any district to tax-

By virtue of its power of eminent domain, the state takes the property of individuals for a public purpose, making just compensation, but without regard to whether it takes more of one man's property than another's.

It is essential to the existence of these powers that they should override private rights. Yet our system of institutions places limitations on them. These limitations are of two distinct classes, between which the division is fundamental. The first class springs from the relations between the Federal government and the states; the second from the relations between the individual or corporation whose property is regulated or taken, and the government, state or Federal, taking or regulating it. The one class is based on political considerations, the other on requirements of justice.

§ 469 *b*. Limitations of the first class apply to the exercise of all three powers. Within the range of its constitutional powers the Federal government is superior to the state governments.¹ The Constitution declares this;² and that it should be so is essential to the existence of the Federal government as the government of a nation of which the states are constituent parts. Consequently, wherever there is concurrent authority in the Federal and state governments, and the Federal government legislates, state laws in so far as inconsistent must yield. Certain powers moreover, conferred on Congress, are essentially exclusive, even while unexercised, as for instance the power to regulate commerce with foreign nations and among the states. Therefore state legislation cannot extend within their domain, and besides this, the Federal Constitution in close connection with these exclusive powers of Congress, places certain express prohibitions on the states, forbidding them, for instance, to lay imposts or duties on exports and imports. Nevertheless, the

ation for a local improvement. The rule of equality and uniformity prescribed in cases of taxation for state and county purposes, does not require that all property or all persons in a county or district should be taxed for local purposes. He who reaps the benefit should bear the burden. *Hagar v. Reclamation District*, 111 U.

S. 700, 705; *Louisiana v. Pillsbury*, 105 U. S. 278, 295; *County of Mobile v. Kimball*, 102 U. S. 691, 704.

¹ *Gibbons v. Ogden*, 9 Wheat. 1, 210; *Tennessee v. Davis*, 100 U. S. 257, 263. See *Transportation Co. v. Wheeling*, 99 U. S. 273, 281.

² Art. VI. § 2.

Federal government, though supreme within its sphere, possesses only such powers as are conferred on it by the Constitution; and Federal legislation beyond the scope of these powers is void.¹

The second class of restrictions is summed up in the two fundamental rules that no man's property shall be taken without (1) due process of law, and (2) just compensation. The first is a restriction on the power of eminent domain and the power to tax, the second only on the power of eminent domain and on such instances of the exercise of the police power as raise the question whether property has been taken, and not merely regulated.²

§ 470. By the exercise of its power of eminent domain,³ the state may take the property of corporations for public purposes, on making due compensation, just as the state may take other property.⁴ The exercise of this

Eminent
domain.
Restrictions.

¹ An act of Congress making it a misdemeanor to mix for sale naphtha and illuminating oils, or to sell or offer such mixture for sale, is a police regulation, relating exclusively to the internal trade of the states, and can only have effect where the legislative authority of Congress excludes territorially all state legislation, as, *e. g.*, in the District of Columbia. Within state limits it can have no constitutional operation. *United States v. Dewitt*, 9 Wall. 41. Property covered by letters-patent is subject to regulation by police powers of a state, like other property. *Patterson v. Kentucky*, 97 U. S. 501.

² No compensation need be made when private property is regulated by the police power. *Talbot v. Hudson*, 16 Gray (Mass.), 417.

³ Eminent domain (or the right or power of eminent domain) "is the rightful authority which exists in every sovereignty to control and regulate those rights of a public nature

which pertain to its citizens in common, and to appropriate and control individual property for the public benefit as the public safety, necessity, convenience, or welfare may demand." *Cooley Cons. Lim'ns*, 524. *People v. Humphrey*, 23 Mich. 471. It will be noticed that the notion of eminent domain given by this definition resembles in some respects notions of the police power. See *infra*, §§ 474 *et seq.*; also §§ 171 *et seq.*

The power of eminent domain is not granted by the state constitution to the legislature, but is inherent in the legislature, limited only by constitutional restrictions. *Central Branch U. P. R. R. Co. v. Atchison, T. and S. F. R. R. Co.*, 28 Kan. 453. A state may condemn property for the use of the United States. *Orr v. Quimby*, 53 N. H. 590.

⁴ A bridge held by an incorporated company under a charter from a state may be condemned and taken as part of a public road, under the laws of that state. This charter, although a

power either by the United States¹ or by a state, is subject to two restrictions contained in the Federal Constitution (as well as in state constitutions): (1) no person shall be deprived of his property without due process of law: (2) nor shall private property be taken for public use without just compensation.²

§ 471. The phrase "due process of law" is one that seems likely for many years to remain without adequate definition. It means the "law of the land," as those words are used in Magna Carta;³ and, consequently,

"Due process of law."

contract between the state and the company, is, like all other private property, subject to the right of eminent domain. The Federal Constitution does not take away this right, the exercise of which does not interfere with the inviolability of contracts. All property and contracts are subject to eminent domain, and property held by an incorporated company stands on the same footing with that held by an individual, and a franchise cannot be distinguished from other property. *West River Bridge Co. v. Dix*, 6 How. 507. Accord, *Central Bridge Co. v. City of Lowell*, 4 Gray, 474; *Metropolitan City R'y Co. v. Chicago West Div. R'y Co.*, 87 Ill. 317; *Sixth Avenue R. R. Co. v. Kerr*, 72 N. Y. 330; *Backus v. Lebanon*, 11 N. H. 19; *Philadelphia Passenger R'y Co.'s Appeal*, 102 Pa. St. 123; *Boston and L. R. R. Co. v. Salem, etc. R. R. Co.*, 2 Gray (Mass.), 1; compare *Enfield Toll Bridge Co. v. Hartford and New Haven R. R. Co.*, 17 Conn. 453; *S. C.*, 17 Conn. 40; *Pennsylvania R. Co.'s Appeal*, 93 Pa. St. 150.

¹ See *Darlington v. United States*, 82 Pa. St. 382.

² Amendment V., which does not apply to the states; *Withers v. Buckley*, 20 How. 84; and Amendment XIV., which does apply to the states. The provision that private property

shall not be taken without just compensation is not in Amendment XIV.; but is contained in most of the state constitutions, and, moreover, it is safe to say, as a general principle of law, springing from the nature of our institutions, that no state can take private property by its right of eminent domain, without making just compensation. See §§ 456, 171.

That the right of eminent domain exists in the government of the United States, and may be exercised by it within the states so far as is necessary to the exercise of the powers conferred on the Federal government by the Constitution, was held in *Kohl v. United States*, 91 U. S. 367. The state cannot delegate a right to take property by eminent domain, for a private purpose. § 163 *ante*.

³ *Murray's Lessee v. Hoboken Land Co.*, 18 How. 272. Magna Carta was granted or enacted by John "per consilium" of his primate, his barons, and the papal legate. The thirty-ninth section, which contains the phrase in question, runs thus: "Nullus liber homo capiatur, vel imprisonetur, aut dissaisiatur, aut utlagetur, aut exuletur, aut aliquomodo destruat, nec super eum ibimus, nec super eum mittimus, nisi per legale iudicium parium suorum vel per legem terrae." *Stubb's Select Charters*, 276-291. See § 492.

it means something which is continuously undergoing modification and development. The provision in Magna Carta is a restriction on the power of the Crown rather than on that of Parliament; but the provision in our Constitution that no person shall be deprived of his property without due process of law is a restriction on the power of the state governments acting in any manner whatsoever, and on the power of the Federal government.¹

§ 472. When applied to judicial proceedings, the term "due process of law" means a course of legal proceedings according to the rules and principles which have been established in our systems of jurisprudence for the protection and enforcement of private rights. To give such proceedings validity, there must be a tribunal competent by the law of its creation to pass upon the subject-matter of the suit, and, if the suit involves merely a determination of the personal liability of the defendant, he must be brought within the jurisdiction of the court by service of process within the state, or by his voluntary appearance.²

§ 473. The other constitutional restriction on the power of eminent domain is that private property shall not be taken

¹ It seems that even before the passage of Amendment XIV., a state could not through its legislature have made *anything* due process of law. See *Murray's Lessee v. Hoboken Land Co.*, 18 How. 272.

² *Pennoyer v. Neff*, 95 U. S. 714, 733; see *St. Clair v. Cox*, 106 U. S. 350; and compare *American Express Company v. Conant*, 45 Mich. 642; *McNichol v. United States Mercantile Reporting Agency*, 74 Mo. 457; *Pope v. Terre Haute Car Co.*, 87 N. Y. 137. Notice is essential. *Campbell v. Campbell*, 63 Ill. 462.

"Due process of law" requires that a party shall be properly brought into court, and that he shall have an opportunity when there to prove any fact which according to the constitution,

and the usages of the common law, would be a protection to him and his property. But the legislature may take away any particular form of remedy, and give a new one. And the "law of the land" means about the same as "due process of law." *People v. Supervisors*, 70 N. Y. 228. "By the law of the land is most clearly intended the general law; a law which hears before it condemns; which proceeds upon inquiry and renders judgment only after trial. The meaning is that every citizen shall hold his life, liberty, property, and immunities under the protection of the general rules which govern society." Webster *arguendo* in *Dartmouth College v. Woodward*, 4 Wheat. 519, 581

without just compensation.¹ To bring a case within the protection of this provision, it is not necessary that property should be *taken* in the narrowest sense of the word: it is enough that some private right be materially impaired.² In determining the value of property taken for public purposes, the same considerations are to be regarded as in the sale of property between private persons. The inquiry should be, what is the property worth in the market, not merely with reference to the uses to which it is at the time applied, but with reference to those to which it is plainly adapted.³

Just compensation.

In the absence of any specific provision in the constitution of a state, a state legislature may regulate in its discretion the mode of exercising the right of eminent domain.⁴ The power to exercise this right may be delegated to private citizens or to corporate bodies, public or private;⁵ but, in the absence of special provision, the right of eminent domain may not be delegated by the person or body receiving it from the state.⁶

§ 474. As by virtue of its power of eminent domain a state may take the property of corporations, so may a state modify

¹ See *Garrison v. City of New York*, 21 Wall. 196. "The power to take private property for public uses, generally termed the right of eminent domain, belongs to every independent government. It is an incident of sovereignty, and requires no constitutional recognition. The provision found in the fifth amendment to the Federal Constitution and in the constitutions of the several states, for just compensation for the property taken, is merely a limitation on the use of the power. It is no part of the power itself, but a condition upon which the power may be exercised." *United States v. Jones*, 109 U. S. 513, 518, opinion of court per Field, J.

² The backing of water so as to overflow the lands of individuals is such a taking. *Pumpelly v. Green Bay Co.*, 13 Wall. 166. See §§ 171-

176 for a fuller discussion of what constitutes such a taking of private property or impairment of private rights (by a corporation) as to require compensation.

³ *Boom Co. v. Patterson*, 98 U. S. 403. See for cases on the rule of damages for property taken by a railroad or other corporation, § 178.

⁴ *Secombe v. Railroad Co.*, 23 Wall. 108.

⁵ *Brayton v. Fall River*, 124 Mass. 95, 97. Compare, *United States v. Jones*, 109 U. S. 513. But this power can never be presumed to exist either in municipal or private corporations. *Phillips v. Dunkirk, Warren, etc. R. Co.* 78 Pa. St. 177; *Allen v. Jones*, 47 Ind. 438. Compare *Pennsylvania R. R. Co.'s Appeal*, 93 Pa. St. 150. See § 163.

⁶ See § 166 *ante*.

corporate constitutions, and regulate corporate property, by virtue of its police power; which is the power necessarily inherent in the state as a self-governing community to pass laws for the public welfare.¹ Thus, in a case where a corporation was chartered with the right to hold lotteries for twenty-five years, and subsequently the state which had chartered it adopted a new constitution containing a provision forbidding lotteries, it was held that this constitution, operating as it did to annul the right of the corporation to hold lotteries, was not repugnant to the Federal Constitution as impairing the obligation of the charter, but was a valid exercise of the police power of the state, which the legislature could not grant away. "No legislature can bargain away the public health or the public morals. The people themselves cannot do it, much less their servants. The supervision of both these subjects of governmental power is continuing in its nature, and they are to be dealt with as the special exigencies of the moment may require. Government is organized with a view to their preservation, and cannot divest itself of the power to provide for them."² But a legislature may grant a franchise, as for instance the exclusive right to supply gas or water to a municipality, and cannot revoke it through the exercise of its police

¹ See *Chicago Life Ins. v. Needles*, 113 U. S. 574. Compare *Lake View v. Rose Hill Cemetery Co.*, 70 Ill. 191.

² *Stone v. Mississippi*, 101 U. S. 814; accord, *State v. Morris*, 77 N. C. 512; see *Slaughter House Cases*, 16 Wall. 36; *Crescent City Slaughter House Co. v. New Orleans*, 33 La. Ann. 934; *Richmond, Fred'g and Pot. R. R. Co. v. City of Richmond*, 26 Gratt (Va.), 83; *Chicago, Burlington, and Q. R. R. Co. v. Haggerty*, 67 Ill. 113. In matters relating to the public health and the public morals the legislature of a state cannot by any contract limit the exercise of its police power to the prejudice of the general welfare. Legislation abrogating valid

exclusive privileges of slaughtering animals held constitutional. *Butchers' Union Slaughter House, etc. Co. v. Crescent City Co.*, 111 U. S. 746. The legislation held valid in this case destroyed the exclusive nature of the privileges held valid in *Slaughter House Cases*, 16 Wall. 36. A law prohibiting the employment of women and persons under eighteen in any manufacturing establishment more than sixty hours a week violates no contract of the commonwealth implied in granting the charter of a manufacturing company. *Commonwealth v. Hamilton M'fg Co.*, 120 Mass. 383. See *Woodlawn Cemetery v. Everett*, 118 Mass. 354.

power after the grantee has performed the conditions of the grant: yet by granting such franchises the legislature does not part with its power to regulate them so as to protect the public health and morals.¹

§ 474 a. In the exercise of its police power a state must avoid infringing the restrictions before referred to:² (1) it must not enter the domain of legislation exclusively reserved to Congress by the Constitution, or interfere with Federal regulations constitutionally made; and (2) it must not take the property of an individual or a corporation without just compensation determined by due process of law.

§ 474 b. The opinion of the Supreme Court of the United States in *Gibbons v. Ogden*,³ delivered by the great Chief Justice, is still "the accepted canon of construction" of the commerce clause in the Constitution.⁴ The main point decided in that case was that the New York statutes giving to Fulton and Livingstone the exclusive right to navigate by steam all waters within the territorial jurisdiction of New York State were unconstitutional in so far as they excluded from those waters vessels licensed for the coasting trade under United States laws.⁵ Marshall expounded the clause broadly, and *Gibbons v. Ogden* is recognized as authority for the following propositions:

Police
power.
Commerce
clause.

The power of Congress to regulate commerce has no limitations other than those prescribed in the Constitution.⁶

The power to regulate is the power "to prescribe the rule by which commerce is to be governed."⁷

Commerce among the states cannot stop at the boundary of each state; so the power of Congress to regulate commerce

¹ *New Orleans Gas Co. v. Louisiana Light Co.*, 115 U. S. 650; *New Orleans Water Works Co. v. Rivers*, 115 U. S. 674; *Louisville Gas Co. v. Citizens' Gas Co.*, 115 U. S. 683; *Tammany Water Works v. New Orleans*, 120 U. S. 64.

² *Ante*, §§ 469 a, 469 b.

³ 9 Wheat. 1.

⁴ *Henderson v. Mayor of New York*, 92 U. S. 259, 270.

⁵ Compare *Pensacola Tel. Co. v. Western Un. Tel. Co.*, 96 U. S. 1, which held that a state could not give a telegraph company a monopoly within certain of its own counties, when Congress had regulated interstate telegraphing.

⁶ *Gibbons v. Ogden*, 9 Wheat. 1, 196; approved in *Brown v. Maryland*, 12 Wheat. 419, 446.

⁷ *Ib.*, 9 Wheat. 196.

among the states reaches into their interiors, although it does not extend to the regulation of commerce entirely confined to one state.¹ "The power of Congress, then, comprehends navigation within the limits of every state in the Union; so far as that navigation may be in any manner connected with commerce with foreign countries or among the several states or with the Indian tribes."²

The power of Congress to regulate commerce extends to carriers of passengers,³ and comprehends every species of commercial intercourse between the United States and foreign nations.⁴ "Commerce undoubtedly is traffic, but it is something more; it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches, and is regulated by prescribing rules for carrying on that intercourse. The mind can scarcely conceive a system for regulating commerce between nations, which shall exclude all laws concerning navigation, which shall be silent on the admission of the vessels of the one nation into the ports of the other, and be confined to prescribing rules for the conduct of individuals, in the actual employment of buying and selling, and of barter."⁵ But "inspection laws, quarantine laws, health laws of every description, as well as laws for regulating the internal commerce of a state, and those which respect turnpike roads, ferries, etc.," are within the proper scope of state legislation.⁶

§ 474 c. Regarding commerce by water, it is held that a state may authorize a city to build wharves on navigable waters and to charge fees for their use,⁷ but in so doing must not discriminate against inter-state commerce in favor of commerce

¹ *Ib.* 9 Wheat. 194, approved in *Brown v. Maryland*, 12 Wheat. 419. See *United States v. Forty-three Gallons of Whiskey*, 93 U. S. 188; *Guy v. Baltimore*, 100 U. S. 434.

² *Gibbons v. Ogden*, 9 Wheat. 1, 197. See *United States v. Coombs*, 12 Pet. 72.

³ *Gibbons v. Ogden*, 9 Wheat. 1, 215.

⁴ *Ib.* 9 Wheat. 1, 190 *et seq.*

⁵ *Ib.* 9 Wheat. 1, 189, 190.

⁶ *Ib.* 9 Wheat. 1, 203; *Cardwell v. Bridge Co.*, 113 U. S. 205; *Morgan's Steamship Co. v. Louisiana Board of Health*, 118 U. S. 455. See *Conway v. Taylor's Executor*, 1 Black. 603.

⁷ *Packet Co. v. St. Louis*, 100 U. S. 423; *Packet Co. v. Keokuk*, 95 U. S. 80; *Vicksburg v. Tobin*, 100 U. S. 430; *Packet Co. v. Catlettsburg*, 105 U. S. 559; *Ouachita Packet Co. v. Aiken*, 121 U. S. 444.

wholly internal to the state.¹ And a state may regulate the management of vessels within its harbors.² It may be that by proper and just regulations a state can protect itself against objectionable immigrants, and to that end require full information regarding all immigrants;³ but a state cannot lay a tax on immigrants, however veiled in the form of harbor or quarantine regulations;⁴ and a law prescribing terms or conditions on which alone a vessel can discharge its passengers is a regulation of commerce, and is a regulation of commerce with foreign nations if the vessel comes from a foreign port; it is no argument to call the power to pass such regulations the police power, for a state cannot exercise that power in matters confided exclusively to the jurisdiction of Congress.⁵

§ 474 *d.* "Commerce on land between the different states is so strikingly dissimilar, in many respects, from commerce by water, that it is often difficult to regard them in the same aspect in reference to the respective constitutional powers and duties of the state and Federal governments. No doubt commerce by water was principally in the minds of those who

¹ *Guy v. Baltimore*, 100 U. S. 434.

² *Cooley v. Board of Wardens*, 12 How. 299; *County of Mobile v. Kimball*, 102 U. S. 691; *Wilson v. McNamee*, 102 U. S. 572. But compare *Foster v. Master, etc. of New Orleans*, 94 U. S. 246; *Steamship Co. v. Portwardens*, 6 Wall. 31.

³ See *City of New York v. Miller*, 11 Pet. 102.

⁴ *Passenger Cases*, 7 How. 283; *Henderson v. Mayor of New York*, 92 U. S. 259; *Chy Lung v. Freeman*, 92 U. S. 275; *People v. Compagnie Générale Transatlantique*, 107 U. S. 59.

⁵ *Henderson v. Mayor of New York*, 92 U. S. 259, 271, 272. See *Gloucester Ferry Co. v. Pennsylvania*, 114 U. S. 196.

By examining the cases in the Supreme Court, in which state legislation has been adjudged invalid in regard

to the commerce clause, "it will be found that the legislation adjudged invalid imposed a tax upon some instrument or subject of commerce, or exacted a license fee from parties engaged in commercial pursuits, or created an impediment to the free navigation of some public waters, or prescribed conditions in accordance with which commerce in particular articles or between particular places was required to be conducted. In all the cases, the legislation condemned operated directly upon commerce, either by way of tax upon its business, license upon its pursuit in particular channels, or conditions for carrying it on." *Sherlock v. Alling*, 93 U. S. 99. Opinion of the Court per Field, J., p. 102; as to the power of Congress to pass such laws, see *Head Money Cases*, 112 U. S. 580.

framed and adopted the Constitution, although both its language and spirit embrace commerce by land as well."¹ State legislation seeking to impose a direct burden on inter-state commerce by land or water, or to interfere directly with its freedom, encroaches on the exclusive power of Congress.² Thus, a statute of Missouri prohibiting driving or conveying Texan, Mexican, or Indian cattle into the state between the first days of March and November is an unconstitutional regulation of inter-state commerce.³ But, Congress not having acted on the subject, it is held not to conflict with the powers of Congress to regulate inter-state commerce, for several states by concurrent legislation to consolidate railroad companies so as to create a consolidated corporation running a continuous line of road through several states,⁴ and state statutes regulating the tolls of railroad companies within state limits, making no discrimination between local and inter-state rates, are constitutional police regulations, so far as regards the commerce clause in the Constitution, even though they affect a railroad company operating a road through several states.⁵ Thus, as far as regards this clause, a state may constitutionally prescribe a maximum charge for the transportation of passengers and merchandise carried within the state, or taken up outside the state and brought into it, or taken up inside and carried out—at least until Congress legislates concerning inter-state commerce.⁶

¹ *Railroad Co. v. Maryland*, 21 Wall. 456, 470; *Opin. of Ct. per Bradley, J.*

² *Hall v. DeCuir*, 95 U. S. 485. See *Western Union Tel. Co. v. Pendleton*, 122 U. S. 347. So long as Congress does not pass any law regulating commerce among the states, it indicates its will that inter-state commerce should be free and untrammelled. *Brown v. Houston*, 114 U. S. 622.

³ *Railroad Co. v. Husen*, 95 U. S. 465. For the power of states to authorize bridges over their navigable waters see *Gilman v. Philadelphia*, 3 Wall. 713; *Escanaba Co. v. Chicago*,

107 U. S. 678; *People v. Saratoga, etc. R. R. Co.*, 15 Wend. (N. Y.) 113; *Railroad Co. v. Richmond*, 19 Wall. 584.

⁴ *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157. This seems tacitly recognized in many cases in the Federal Supreme Court.

⁵ *Railroad Co. v. Fuller*, 17 Wall. 560.

⁶ *Peik v. Chicago, etc. Ry. Co.*, 94 U. S. 164; *Chicago, etc. R. R. Co. v. Iowa*, 94 U. S. 155; *People v. Wabash, etc. Ry. Co.*, 104 Ill. 476; S. C. 105 Ill. 236. But see *Carton & Co. v. Illinois Central R. R. Co.*, 59 Iowa, 148. But a state statute regu-

§ 475. Turning now to a consideration of the restrictions placed on the police power by the requirements of justice, it may be remarked that the term "police power" is not well chosen, as the power in question extends somewhat beyond the scope of what are ordinarily regarded as police regulations.¹ The limits of this power are necessarily undefinable, as, in accordance with its essential nature and purposes, its exercise must depend on circumstances. Whether any given enactment or regulation comes properly within its limits is a question resting for decision in the first instance with the legislature, but reviewable by the courts. Its scope is greater with respect to property in the management of which the public has a plain interest, as a railroad,² or a ferry, or even a grain elevator.

Police power. Its limits. Property in which the public has an interest.

lating railroad charges for a transportation which constitutes a part of commerce among the states is void. *Wabash, St. L. & P. Ry. Co. v. Illinois*, 118 U. S. 557. Congress has now passed an "Inter-State Commerce Bill." No questions under it have yet come before the courts; and how far it will operate to restrict state legislation it is impossible to say.

¹ "Police is in general a system of precaution for the prevention of crimes and calamities." J. Bentham, *Edinburgh Ed. of Works*, part ix. p. 157; quoted in *Kansas Pacific Ry. Co. v. Mower*, 16 Kan. 573.

² The legislature can compel a railroad company to fence its road. *Thorpe v. Rutland and Burlington R. R. Co.*, 27 Vt. 140; *Gorman v. Pacific Railroad*, 26 Mo. 441; *Kansas Pacific R. R. Co. v. Mower*, 16 Kan. 573; *New Albany and Salem R. R. Co. v. Tilton*, 12 Ind. 3; *Ohio and Mississippi R. R. Co. v. McClelland*, 25 Ill. 140; see *Hayes v. Michigan Central R. R. Co.*, 111 U. S. 228. And make it liable in double damages for stock killed till it is fenced; *Missouri*

Pac. Ry. Co. v. Humes, 115 U. S. 512; *Humes v. Missouri Pac. Ry. Co.*, 82 Mo. 221; to ring bells or whistle before crossing a road; *Galena, etc. R. R. Co. v. Loomis*, 13 Ill. 548; to erect a bridge necessary for travellers along a turnpike; *People v. Boston and Albany R. R. Co.*, 70 N. Y. 569; to stop trains at a certain station (right to alter and repeal being reserved); *Railroad Co. v. Hamersley*, 104 U. S. 1; *Chicago and Alton R. R. Co. v. People*, 105 Ill. 657; *State v. New Haven and Northampton Co.*, 43 Conn. 351; *Pennsylvania Co. v. Wentz*, 37 Ohio St. 333; *Commonwealth v. Eastern R. R. Co.*, 103 Mass. 254; to light their tracks in cities; *Cincinnati H. and D. R. R. Co. v. Sullivan*, 32 O. St. 152. So the legislature may regulate the speed of locomotives in passing through cities and towns; *Mobile and Ohio R. R. Co. v. State*, 51 Miss. 137; *Myers v. C. R. I. and P. R. Co.*, 57 Iowa, 555; see *State v. East Orange*, 41 N. J. L. 127; or at highways and crossings; see *Rockford, etc. R. R. Co. v. Hillmer*, 72 Ill. 235; *Horn v. Chicago*,

The following extract is from the opinion of the majority of the court by Chief Justice Waite, in *Munn v. Illinois*:¹ "Looking then to the common law from whence came the right which the constitution protects, we find that when private property is 'affected with a public interest it ceases to be *juris privati* only.' This was said by Lord Chief Justice Hale more than two hundred years ago in his *Treatise De Portibus Maris*, 1 Harg. Law Tracts, 78, and has been accepted without objection as an essential element of the law of property ever since. Property does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but so long as he maintains the use, he must submit to the control."²

§ 476. These remarks are undoubtedly sound as far as they go. The real difficulty, however, is to draw a line between property in the management of which the public has a clearly defined interest, and property in regard to which it has none. Where the property in question is that of a corporation, the interest of the public might be roughly said to be coextensive with the grant to the corporation of powers which it would be

etc. R. R. Co., 38 Wis. 463; Toledo P. and W. Ry. Co. v. Deacon, 63 Ill. 91; and may regulate the grade of railways, and prescribe how railway tracks shall cross each other; Fitchburg R. R. Co. v. Grand Junction R. R. Co., 1 Allen, 552; Pittsburgh, etc. R. R. Co. v. South West Penn. R. R. Co., 77 Pa. St. 173; compare *State v. Noyes*, 47 Me. 189; and a city may forbid a railroad company to run its trains by steam within certain parts of the city; *Railroad Co. v. Richmond*, 96 U. S. 521. A legislature may impose penalties for delays in forwarding freight. *McGowan v. Wilmington*,

etc. R. R. Co., 95 N. C. 417. Such regulations as the above, in order to be a valid exercise of the police power, must be reasonable. *Toledo, W. and N. Ry. Co. v. Jacksonville*, 67 Ill. 37. ¹ 94 U. S. 113, 126 (*Elevator Cases*).

² The property of a telephone company is property in the use of which the public is interested—it is property devoted to a public use—and its rates may be fixed by statute. *Hockett v. State*, 105 Ind. 250; *Central Union Telephone Co. v. Bradbury*, 106 Ind. 1.

unconstitutional or improper for the legislature to grant, except for purposes in the attainment of which the public was directly concerned. For instance, it is ordinarily incompetent for the legislature to grant the right of taking private property on compulsory process except for the attainment of an object of public importance.¹ Accordingly, as this right is ordinarily granted to a railroad corporation, the possession of the right by such corporation would seem to indicate a clear interest on the part of the public in its affairs. This is a clear case of a defined public interest in a private enterprise. But such a test, taken by itself, is not applicable to all cases; for the public is sometimes held to have an interest in enterprises where no such extraordinary powers have been granted, as, for instance, in the grain elevator case, whence the foregoing extract is taken. The truth of the matter seems to be, that what may constitute such an interest of the public in private enterprises as will warrant the regulation of them by the police power of the state, is essentially incapable of definition. The Chief Justice says: "When, therefore, one devotes his property to a use in which the public has an interest, he in effect grants to the public an interest in that use." What is "a use in which the public has an interest"? To this question the remarks of the Chief Justice give no answer. In any private business, as the manufacture of soap, the public has always at least this negative interest that the business shall not be carried on in such a way as to become a public nuisance. Yet the business of manufacturing soap is as private as any business can be. Take for another example, the business of supplying milk in a city. This is a business in which the public is held to have an interest to this extent, that the milk supplied shall be pure and wholesome.² In truth, the interests of a society, be they called public or private, are so correlated and interwoven that it is impossible to pick out the life or occupation of any individual and say: that is an occu-

¹ See *Beekman v. Saratoga and Schenectady R. R. Co.*, 3 Paige, 73; *Wend.* 9, 55; *Edgewood R. R. Co.'s Appeal*, 79 Pa. St. 257.

Ten Eyck v. Delaware, etc. Canal Co., 18 N. J. Law, 200; *Bloodgood v. Mohawk and Hudson R. R. Co.*, 18 Mass. 11. ² See *Commonwealth v. Evans*, 132

pation in which the public has no conceivable interest.¹ Whatever the public welfare calls for, the police power of the state exists to afford, and whether any given exercise of this power is a proper one, is a question for the discretion of the legislature, subject to review in some way by the courts.²

¹ "The sovereign police power which the state possesses is to be exercised only for the general public welfare, but it reaches to every person, to every kind of business, to every species of property within the Commonwealth." *People v. Salem*, 20 Mich. 452, 478, per Cooley, J.

² "As a general proposition it may be stated, it is the province of the law-making power to determine when the exigency exists, calling into exercise this (police) power. What are the subjects of its exercise, is clearly a judicial question." *Lake View v. Rose Hill Cemetery Co.*, 70 Ill. 191, 195, opinion of court per Scott, J. See also *Toledo, W. and N. Ry. Co. v. City of Jacksonville*, 67 Ill. 37. A few more decisions on the exercise of the police power are given in this note.

If the public safety or the public morals require the discontinuance of any manufacture or traffic, the legislature cannot be stayed from providing for its discontinuance by any incidental inconvenience which individuals or corporations may suffer. All rights are held subject to the police power of the state. The court said, that they did not mean to hold that property actually in existence, in which the right of the owner had become vested, could be taken for the public good without just compensation; but that they did hold, in accordance with *Bartemeyer v. Iowa*, 18 Wall. 129, that as a measure of public regulation, a state law prohibiting the manufacture and sale of

intoxicating liquors is not repugnant to the Constitution (the charter of the corporation in this case was subject to alteration and repeal). *Beer Co. v. Massachusetts*, 97 U. S. 25. The appropriate regulation of the use of property is not a "taking" of property within the meaning of the Federal Constitution. *Railroad Co. v. Richmond*, 96 U. S. 521. The charter of a fertilizing company, organized to make dead animals into manure, is a sufficient license until revoked; but it cannot be regarded as a contract guaranteeing exemption from the exercise of the police power of the state, however serious the nuisance may become by reason of the growth of population. *Fertilizing Co. v. Hyde Park*, 97 U. S. 659.

The legal tender acts are constitutional, whether applied to contracts made before or after their passage. *Legal Tender Cases*, 12 Wall. 457, overruling *Hepburn v. Griswold*, 8 Wall. 603; Chase, C. J., and Clifford, Field, and Nelson, JJ., dissenting. Giving the opinion of the majority of the court, Strong, J., said: "As in a state of civil society property of a citizen or subject is ownership subject to the lawful demands of the sovereign, so contracts must be understood as made in reference to the possible exercise of the rightful authority of the government, and no obligation of a contract can extend to the defeat of the legitimate government authority." 12 Wall. 551. And see the constitu-

§ 476 *a.* *Munn v. Illinois*¹ is the leading case on the power of the state to regulate charges for the use of property devoted to a public use. It decided that the legislature could regulate the charges for storing grain demanded by the owners of grain elevators in large cities. Similar considerations arise with regard to the right of legislatures to limit tolls charged by railroad companies.

Elevator
case. Rail-
road
charges.

“Railroad companies are carriers for hire. They are incorporated and given extraordinary powers in order that they may the better serve the public in that capacity. They are, therefore, engaged in a public employment affecting the public interest, and (under the decision in *Munn v. Illinois*) subject to legislative control as to their rates of fare and freight, unless protected by their charters. . . . This company in the transaction of its business has the same rights, and is subject to the same control as private individuals under the same circumstances. It must carry when called upon to do so, and can charge only a reasonable rate for the carriage. In the absence of any legislative regulation upon the subject, the courts must decide for it, as they do for private persons, when controversies arise, what is reasonable. But when the legislature steps in, and prescribes a maximum of charge, it operates upon this corporation the same as it does upon individuals engaged in a similar business. It was within the power of the company to call upon the legislature to fix permanently this limit, and make it a part of the charter; and, if it was refused, to abstain from building the road and establishing the contemplated business. If that had been done, the charter might have presented a contract against future legislative interference. But it was not; and the company invested its capital, relying upon the good faith of the people and the wisdom and impartiality of legislators for protection against wrong under the form of legislative regulation.”²

tionality of these acts re-affirmed (Field, J., only, dissenting) in *Legal Tender Case*, 110 U. S. 421.

¹ 94 U. S. 113.

² *Chicago, etc. R. R. Co. v. Iowa*, 94 U. S. 155, 161, 162; opinion of

court per Waite, C. J. These remarks are authoritative. Accord, *Peik v. Chicago, etc. Ry. Co.*, 94 U. S. 164; *Chicago, etc. R. R. Co. v. Ackley*, 94 U. S. 179; *Ruggles v. State of Illinois*, 108 U. S. 526; *Blake v. Wi-*

§ 476 b. When, however, power has been expressly given a railroad company to take tolls in its discretion, without any legislative reservation, the state cannot regulate its tolls and charges, as that would impair the obligation of the contract between the corporation and the state; and the police power does not extend so far as to impair or destroy a franchise or a power essential to its exercise.¹ But "grants of immunity from legitimate governmental control are never to be presumed. On the contrary, the presumptions are all the other way, and unless an exemption is clearly established the legislature is free to act on all subjects within its general jurisdiction, as the public interest may seem to require."² Accordingly, only when the terms are clear and express will the legislature be held to have granted away its rights to regulate tolls.³ Thus, an amendment in a charter gave the directors of a railroad company power to establish rates of toll as they should by their by-laws determine, but provided that their by-laws should not be repugnant to the laws of the state. It was held that the amendment did not release the company from restrictions upon rates of toll contained in the laws of the state.⁴ In this case in a concurring opinion, Harlan, J., said, after reviewing the cases on the subject, that the cases established these principles: "1. That the charter of a railroad corporation is a contract within the meaning of the

**nona*, etc. R. R. Co., 19 Minn. 418; *aff'd sub nom.* Winona, etc. R. R. Co. v. Blake, 94 U. S. 180; Illinois Central R. R. Co. v. People, 95 Ill. 313. And the state may attach a penalty for taking more tolls than allowed by statute. *State of Minnesota v. Winona, etc. R. R. Co.*, 19 Minn. 434; *Mobile and M. Ry. Co. v. Steiner*, 61 Ala. 559. Compare *Chicago and A. R. R. Co. v. People*, 67 Ill. 11; *Wabash, St. L. and P. Ry. Co. v. People*, 105 Ill. 286. But such a penalty cannot constitutionally be attached to past acts and omissions. *Wilson v. Ohio, etc. Ry. Co.*, 64 Ill. 542.

¹ *Philadelphia, W. and B. R. R. Co. v. Bowers*, 4 Houst. (Del.) 506;

Attorney-General v. Railroad Cos., 35 Wis. 425; *Sloan v. Pacific R. R. Co.*, 61 Mo. 24; *Iron R. R. Co. v. Lawrence Furnace Co.*, 29 O. St. 208; see *Pingry v. Washburn*, 1 Aiken (Vt.), 264; *semble*, contra, *Illinois Central R. R. Co. v. People*, 95 Ill. 313.

² *Ruggles v. State of Illinois*, 108 U. S. 526, 531.

³ *Railroad Commission Cases*, 116 U. S. 307; *Illinois Central R. R. Co. v. People*, 95 Ill. 313; *Georgia R. R. v. Smith*, 70 Ga. 694; *Shields v. Ohio*, 95 U. S. 319.

⁴ *Ruggles v. State of Illinois*, 108 U. S. 526.

contract clause in the Federal Constitution. 2. That such corporation may be protected by its charter against absolute legislative control in the matter of rates for the carriage of passengers and freight. 3. That when the charter is granted subject to such regulations as the legislature from time to time may provide, or subject to the authority of the legislature to alter or repeal it, in either of such cases the legislature has the same power over rates or tolls that it had when the charter was granted. 4. In the absence of statutory regulations upon the subject, it is necessarily implied from the occupation of a railroad corporation that it shall exact only reasonable compensation for carriage."¹

§ 477. Another power necessary to the existence of the state, which, while it may perhaps be regarded as incidental to the police power, is important enough for detailed discussion, is the power to tax, that is to take The taxing power. the property of individuals for a public use,² without making compensation.³ Perplexing questions arise in the construction of statutes imposing taxes on corporate property, because of the equivocal use of such phrases as "capital stock," "shares of stock," "stock," "franchises," "earnings,"⁴ etc. Very likely no one has a clear understanding of all these phrases. At all events their meaning, as they are used in tax statutes, is so ambiguous that it can only be determined from the context, and accordingly a decision construing any of these terms is apt to be of doubtful application in any other case than that in which it was rendered.

Said Chief Justice Waite, giving the opinion of the Federal Supreme Court in *Tennessee v. Whitworth*:⁵ "In corporations four elements of taxable value are sometimes found: 1, franchises; 2, capital stock in the hands of the corporation; 3, corporate property;⁶ and 4, shares of the capital stock in the

¹ 108 U. S. 537.

² There can be no lawful tax which is not levied for a public purpose. *Loan Association v. Topeka*, 20 Wall. 655; *Parkersburg v. Brown*, 106 U. S. 487.

³ See *Gilman v. City of Sheboygan*, 2 Black, 510; and § 469 a.

⁴ As to earnings and profits see § 565. Also *Memphis and C. R. R. Co. v. United States*, 108 U. S. 228.

⁵ 117 U. S. 129.

⁶ A tax upon the capital stock of a company is a tax upon its property and assets. *Commonwealth v. Standard Oil Co.*, 101 Pa. St. 119; *Fox's Ap-*

hands of the individual stockholders. Each of these is, under some circumstances, an appropriate subject of taxation; and it is no doubt within the power of a state, when not restrained by constitutional limitations, to assess taxes upon them in a way to subject the corporation or the stockholders to double taxation. Double taxation is, however, never to be presumed."

§ 477 a. A construction of tax laws that will impose double taxation is not to be adopted unless required by the express words of the statute or by necessary implication.¹ The franchise of a corporation is plainly distinct from its capital or property; consequently, a tax on the franchise coupled with a tax on the capital or property of a corporation is not double taxation.² And the franchise of a railroad company, for instance, may be valued for taxation separately from its property.³ Further, the capital stock of a corporation is distinct from the shares of its capital stock, which represent or constitute the legal interest of the shareholders in the corporate property;⁴ consequently, both the capital stock

peal, 112 Pa. St. 337. There is no double taxation where a corporation is assessed on its tangible property, and also on the value of its capital stock in excess of the value of its tangible property. *Porter v. Rockford*, etc. R. R. Co., 76 Ill. 561; *Chicago, B. and Q. R. R. Co. v. Siders*, 88 Ill. 320.

¹ *Salem Iron Factory v. Danvers*, 10 Mass. 514; *Amesbury Woolen*, etc. Co. v. *Amesbury*, 17 Mass. 461; *Bank of Georgia v. Savannah*, *Dudley* (Ga.), 130; *Iron City Bank v. Pittsburgh*, 37 Pa. St. 340; *Cooley on Taxation*, 2d ed., 227.

² *Carbon Iron Co. v. Carbon County*, 39 Pa. St. 251; *Lackawanna Iron*, etc. Co. v. *County of Luzerne*, 42 Pa. St. 424; *Delaware R. R. Tax*, 18 Wall. 206; *Commonwealth v. Lowell Gas Light Co.*, 12 Allen (Mass.), 75; *Commonwealth v. Hamilton M'f'g Co.*, 12 Allen (Mass.), 298; *Monroe*

Savings Bank v. Rochester, 35 N. Y. 365; *Spring Valley Water Works v. Schottler*, 62 Cal. 69.

³ *Wilmington, C. and A. R. R. Co. v. Board of Com'rs*, 72 N. C. 10. For cases on the valuation of capital stock and franchises, see *State Railroad Tax Cases*, 92 U. S. 575; *Railroad Co. v. Vance*, 96 U. S. 450; *Boston and L. R. R. Co. v. Commonwealth*, 100 Mass. 399; *People v. Equitable Trust Co.*, 96 N. Y. 387.

When the statute requires the capital stock of a corporation to be assessed at its "actual value," it should be estimated above or below par, according to the fact. *Oswego Starch Factory v. Dolloway*, 21 N. Y. 449.

⁴ *Farrington v. Tennessee*, 95 U. S. 679, 686; *New Orleans v. Houston*, 119 U. S. 265; *State Bank v. City of Richmond*, 79 Va. 113; *Porter v. Rockford*, etc. R. R. Co., 76 Ill. 561.

and the shares thereof in the hands of shareholders may be taxed, and still there be no double taxation.¹ As Justice Nelson said, giving the opinion of the Federal Supreme Court in *Van Allen v. Assessors*: "The tax on shares is not a tax on the capital of the bank. The corporation is the legal owner of all the property of the bank. . . . The interest of the shareholder entitles him to participate in the net profits earned by the bank in the employment of its capital, during the existence of its charter, in proportion to the number of his shares; and upon its dissolution or termination, to his proportion of that which may remain of the corporation after the payment of its debts. This is a distinct independent interest or property held by the shareholder, like any other property that may belong to him."²

§ 478. The Federal Congress, in the exercise of powers conferred on it by the Constitution, may tax the property of corporations: "The Congress shall have power to ^{Power of Congress.} lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States."³ But the power of Congress to tax is restricted to the scope of the purposes thus specified, and also by the following provisions:—

¹ Cases in last note. But see *Cheshire County Telephone Co. v. State*, 63 N. H. 167. A statute requiring the corporation to pay a tax on the shares of its stock irrespective of the fact whether there are dividends or not, is substantially a tax on the corporation. *New Orleans v. Houston*, 119 U. S. 265.

² 3 Wall. 573, 583. See §§ 483, 484. For purposes of taxation the *situs* of shares is at the residence of the owner, unless otherwise declared by statute. *Ogden v. City of St. Joseph*, 90 Mo. 522.

³ Cons., sec. 8, art. I.

The ninth section of the act of Congress of July 13, 1866, providing that every national bank, state bank, or

state banking association shall pay a tax of ten per cent. on the amount of the notes of any state bank or state banking association paid out by them after August 1, 1866, does not lay a direct tax within the meaning of the Constitution, and is constitutional. Congress, having undertaken in the exercise of undisputed constitutional power to provide a currency for the whole country, may constitutionally secure the benefit of it to the people by appropriate legislation, and to that end may restrain the circulation of any notes not issued under its authority. *Veazie Bank v. Fenno*, 8 Wall. 533; see *National Bank v. United States*, 101 U. S. 1.

"All duties, imposts, and excises shall be uniform throughout the United States."¹

"No capitation or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken."²

"No tax or duty shall be laid on articles exported from any state."²

"No preference shall be given by any regulation of commerce or revenue to the ports of one state over those of another; nor shall vessels bound to or from one state be obliged to enter, clear, or pay duties in another."²

§ 479. Unlike the taxing power of Congress, the power of a state to tax the property of corporations is not restricted in the scope of its purposes and objects by the Federal Constitution; nor do the specific restrictions above referred to, on the taxing power of Congress, apply to the states. But, on the other hand, the power of a state to tax is subject to restrictions to which the taxing power of Congress is not; and, in the first place, is limited by the territorial limitations to the political jurisdiction of the state.³ Thus, a state cannot tax the interest on bonds held by a non-resident, secured by a railroad mortgage, although the railroad lies within the limits of the state; for such bonds are property in the possession of their owners, and when held by non-residents, are property beyond the jurisdiction of the state, and, consequently, not subject to her tax laws, which can have no extra-territorial operation.⁴ Neither can a state tax the entire

Power of
the states.
Restrictions.

¹ Cons., sec. 8, art. I.

² Cons., sec. 9, art. I. Direct taxes within the meaning of the Constitution are only capitation taxes and taxes on land. *Springer v. United States*, 102 U. S. 586.

³ *Commonwealth v. Standard Oil Co.*, 107 Pa. St. 119.

⁴ *Case of the State Tax on Foreign Held Bonds*, 15 Wall. 300. It makes no difference that the mortgaged property lies within the state, for a debt has no *situs* apart from the domicile

of the creditor. *Ib.* See *Kirtland v. Hotchkiss*, 100 U. S. 491; *Bonaparte v. Appeal Tax Court*, 21 Am. Law Reg., N. S. 290 (U. S. Supr. Ct.); *Railroad Co. v. Jackson*, 7 Wall. 262; *Commonwealth v. Chesapeake, etc. R. R. Co.*, 27 Grat. (Va.), 344; *Valle v. Ziegler*, 84 Mo. 214. But personal property other than a debt, may have a *situs* apart from the domicile of the owner, at least for the purposes of taxation. Thus, the legislature of a state may, for the purpose of taxation,

track and equipment, or the total capital stock of a railroad company whose track lies partly without the boundaries of the state; but may tax only the portion of the road within its limits, or such proportion of the total capital stock as represents that portion.¹

Although a state may not tax the franchises of a foreign corporation, it may tax the business; and when a tax is imposed on the "business" of a foreign corporation doing business in the state, the court will not presume that the tax is imposed on the business done outside the state (which might be unconstitutional), although the tax is computed on the capital stock of the corporation.² A foreign corporation, by doing business within a state, does not bring its capital into the state con-

locate shares of stock in a national bank at the bank's place of business, though the shareholders reside elsewhere. *Tappan v. Merchants' National Bank*, 19 Wall. 491; see also *North Carolina R. R. Co. v. Commissioners*, 91 N. C. 454; *St. Albans v. National Car Co.*, 57 Vt. 68; compare *Miller v. United States*, 11 Wall. 269. However, shares may be taxed at the residence of the owner also. Thus, a city may tax its citizens on shares owned by them in the stock of a foreign corporation; and it may do this although the state incorporating the corporation also taxes the shares. *Seward v. City of Rising Sun*, 79 Ind. 351; see *Commonwealth v. Gloucester Ferry Co.*, 98 Pa. St. 105; *McKeen v. Northampton County*, 49 Pa. St. 519; *Worth v. Commissioners*, 90 N. C. 409.

¹ *State Treasurer v. Auditor-General*, 46 Mich. 224. See *Ohio and M. R. R. Co. v. Weber*, 96 Ill. 443. But the United States may tax the interest payable on railroad bonds held by alien non-resident owners; and may compel the corporation to withhold such tax from the bondholders. *United*

States v. Erie R'y Co., 106 U. S. 327. But it is held that in assessing the value of stock for the purposes of state taxation, it is not illegal to include real estate owned by the corporation, but situated outside of the state. *American Coal Co. v. County Commissioners*, 59 Md. 185. A statute provided that the personal property of corporations should be taxed in the town "in which it has its principal place of business or exercises its corporate powers." *Held*, that the principal place of business, within the meaning of this statute, is the place where the governing power of the corporation is exercised. *Middletown Ferry Co. v. Middletown*, 40 Conn. 65. Not where the principal labor of the employes of the corporation is done. *Ib.* Compare *Oswego Starch Factory v. Dolloway*, 21 N. Y. 449.

² *People v. Equitable Trust Co.*, 96 N. Y. 387. A railroad company is "doing business" in a state where part of its road is situated. *Erie R'y Co. v. Pennsylvania*, 21 Wall. 492. Compare *People v. Horn Silver Mining Co.*, 105 N. Y. 76.

structively, so as to subject to taxation its property outside of the state.¹

§ 480. The power of a state to tax is expressly restricted by section 10, article I. of the Federal Constitution: viz: "No state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws,² . . . nor lay any duty on tonnage."³ And the taxing power of a state is also restricted by the clause in Amendment XIV. to the Federal Constitution, which forbids any state to deny to any person within its jurisdiction the equal protection of the laws.⁴ Thus, when a state allows individuals to deduct the amount of the mortgages on their property in estimating its tax valuation, it is unconstitutional for the state to provide that in assessing the property of railroad companies the amount of the mortgages therein shall not be deducted.⁵ And further, to make no provision for giving the company notice of the assessment, and to allow it no chance to be heard in respect thereof, deprive it of its property without due process of law.⁶

On the other hand, as corporations are held not to be citizens within the meaning of the clause in the Constitution which

¹ *Commonwealth v. Standard Oil Co.*, 101 Pa. St. 119. A corporation will be regarded as "doing business" in a state where its officers have their offices, where its directors hold their meetings, where its dividends are declared and paid, and large portions of its property are sold from time to time. It is not essential that all its business be done in the state. *People v. Horne Silver Mining Co.*, 105 N. Y. 76.

² See *Brown v. Maryland*, 12 Wheat. 419; *Turner v. Maryland*, 107 U. S. 38; *People v. Compagnie Générale Transatlantique*, 107 U. S. 59; *Woodruff v. Parham*, 8 Wall. 123; *Pace v. Burgess*, 92 U. S. 372; *Guy v. Baltimore*, 100 U. S. 434; *Tiernan v. Rinker*, 102 U. S. 123; *Higgins v. Three Hundred Casks of Lime*, 130 Mass. 1.

³ See *Peete v. Morgan*, 19 Wall. 581; *Cannon v. New Orleans*, 20 Wall. 577; *Inman Steamship Co. v. Tinker*, 94 U. S. 238; *State Tonnage Taxes*, 12 Wall. 204.

⁴ This provision applies to and protects corporations. *Santa Clara County v. Southern Pacific R. R. Co.*, 118 U. S. 394. But does not protect foreign corporations until they have entered the state. See § 400.

⁵ *Railroad Tax Cases*, 13 Fed. Rep. 722. See *People v. Fire Ass'n*, 92 N. Y. 311. *Contra*, *Central Pac. R. R. Co. v. State Board*, 60 Cal. 35; *San Francisco, etc. R. R. Co. v. State Board*, 60 Cal. 12.

⁶ *Ib.* See *People v. Supervisors*, 70 N. Y. 228; *post*, § 492.

secures to the citizens of each state the privileges and immunities of the citizens in the several states,¹ a state may ordinarily discriminate in its taxation between foreign and domestic corporations,² and may lay additional taxes on a foreign corporation as a condition of its being allowed to transact business within the limits of the state.³

§ 481. But the most important of the restrictions in the Federal Constitution on the power of the states to tax arise by implication from the exigencies of the Federal government, and from the nature of certain powers granted to Congress. Within the scope of its constitutional powers the Federal government is superior to the state governments.⁴ And, since a power to tax the agencies and instruments of a government involves a power to trammel and destroy them, it is evident that any power in the state to tax the agencies and instruments of the national government would be incompatible with that government's existence. Since the greatest of constitutional decisions, *McCulloch v. Maryland*,⁵ these propositions have not been questioned.

Restrictions on the power of the states to tax arising from the exigencies of the Federal government.

¹ Cons., sect. 2, art. IV.; *Pyrolusite Manganese Co. v. Ward*, 73 Ga. 491.

² *Ducat v. Chicago*, 48 Ill. 172; *Phoenix Ins. Co. v. Commonwealth*, 5 Bush (Ky.), 68; *Tatem v. Wright*, 23 N. J. L. 429; see *Commonwealth v. Gloucester Ferry Co.*, 98 Pa. St. 105, and compare *Commonwealth v. Texas and Pacific R. R. Co.*, 98 Pa. St. 90. It is not entirely clear to the writer that these decisions are in accord with the Federal Circuit Court decision of *Railroad Tax Cases*, *supra*. With that decision, however, the view of the New York Court of Appeals, in *People v. Fire Ass'n*, 92 N. Y. 311, is perfectly reconcilable; i. e., that the Amendment XIV., which prohibits states from denying to any person the equal protection of the laws, does not

apply to conditions imposed on foreign corporations on entering the state, although it may afford them security after they have complied with such conditions. See § 400.

³ *People v. Fire Ass'n*, 92 N. Y. 311; *Phoenix Ins. Co. v. Welch*, 29 Kans. 672; *State v. Western Union Telegraph Co.*, 73 Me. 518; *Western Union Tel. Co. v. Mayer*, 28 Ohio St. 521; but see *Clark v. Port of Mobile*, 10 Ins. Law Journal, 357; except where such taxation would conflict with the exercise of powers granted to Congress by the Federal Constitution, see § 486. See also §§ 379 *et seq.*, on the territorial extent of corporate powers.

⁴ See *ante*, § 469 *b*.

⁵ 4 Wheat. 405.

§ 482. The exemption of Federal agencies from state taxation is held to depend, not upon the nature of the agencies, nor upon the manner in which they are constituted, nor even upon the fact that they are such agencies. Does the tax, in truth, impair their power to serve the Federal government as they were intended to serve it? this is the material question.¹ Accordingly, while a state tax on the operations of a Federal agency or instrument would be void as a direct obstruction to the exercise of the powers of the Federal government, yet if such agency or instrument be a stock corporation, a state tax upon its *property* may be valid, provided the tax leaves the corporation free efficiently to discharge its duties to the Federal government, and in no way impairs the functions of the corporation as a Federal agency.² If these propositions are correct, *à fortiori* the employment of a corporation, originally chartered by a state, in the service of the Federal government, does not exempt it from state taxation; at least in the absence of legislation on the part of Congress indicating that such exemption is deemed by Congress essential to the full performance on the part of the corporation of its obligations to the Federal government.³

§ 483. The most numerous and important class of corporations incorporated by Congress are the national banks; which are instruments designed to aid the Federal government in the administration of an important branch of the public service. Being such means and brought into existence for that purpose, the states can exercise no control over them, nor in any way affect their operations, except in so far as Congress may permit.⁴ To what extent na-

¹ Railroad Co. v. Peniston, 18 Wall. 5.
² Railroad Co. v. Peniston, *supra*; National Bank v. Commonwealth, 9 Wall. 353; see Bank of Commerce v. New York City, 2 Black, 620; Bank Tax Case, 2 Wall. 200; Society of Savings v. Coite, 6 Wall. 594; Provident Institution v. Massachusetts, 6 Wall. 611; Hamilton Co. v. Massachusetts, 6 Wall. 633. It may be assumed, however, inasmuch as Congress has power to charter corporations only in furtherance of some Federal object, that any state tax on the property of corporations so chartered, in any way discriminating against them, would be held unconstitutional.

³ Thompson v. Pacific R. R., 9 Wall. 579.

⁴ Farmers', etc. National Bank v. Dearing, 91 U. S. 29; Pollard v.

tional banking interests may be taxed by the states, Congress has provided as follows:—

“Nothing herein shall prevent all the shares in any association from being included in the valuation of the personal property of the owner or holder of such shares, in assessing taxes imposed by authority of the state within which the association is located; but the legislature of each state may determine and direct the manner and place of taxing all the shares of national banking associations located within the state, subject only to the two restrictions, that the taxation shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such state, and that the shares of any national banking association owned by non-residents of any state shall be taxed in the city or town where the bank is located, and not elsewhere. Nothing herein shall be construed to exempt the real property of associations from either state, county, or municipal taxes, to the same extent, according to its value, as other real property is taxed.”¹

§ 484. With reference to these statutory provisions, it was held that the New York statute, passed March 9, 1865, by which it was enacted that shares in a national bank held by any person or body corporate should be “included in the valuation of the personal property of such person or body corporate in the assessment of taxes in the town or ward where such banking association is located, and not elsewhere,” but which did not provide that the tax imposed should not exceed the rate imposed on the shares of any of the banks organized under state authority, is unwarranted and void, no tax having been

State, 65 Ala. 628; *City of Carthage v. First National Bank*, 71 Mo. 508; *Maguire v. Board of Revenue*, 71 Ala. 401.

It is within the constitutional power of Congress to establish a national bank in any state, and provide that its shares shall be exempt from taxation by other states. *Flint v. Board of Aldermen*, 99 Mass. 141; see *McCulloch v. Maryland*, 4 Wheat. 405.

¹ U. S. Rev. Stat. § 5219. See *Boyer v. Boyer*, 113 U. S. 689.

The power of a state to tax national banks comes from the act of Congress, which must be obeyed in thorough good faith. *First National Bank v. St. Joseph*, 46 Mich. 526.

The legislature may tax the property of a corporation and also tax the shareholders separately on their shares. *Cook v. City of Burlington*, 59 Iowa, 251.

laid by the state on shares in the stock of state banks, though there was a tax on the capital of such banks.¹ It was held, however, that, within the limits of the National Banking Act, a state might tax the entire interest of the shareholder in national banking shares; and that, too, without regard to the fact that a part or the whole of the capital of the bank was invested in Federal bonds exempted from state taxation by act of Congress. Such a tax the court considered but a tax on the new uses or privileges conferred by the charters of national banks in respect of the bonds, and a valid condition annexed to their new use.² If the rate of taxation by a state on the shares in national banks is not greater than the rate upon the moneyed capital of individuals which is subject to taxation; that is, if no greater proportion or percentage of tax is levied on the valuation of such shares than is levied upon other taxable moneyed capital in the hands of citizens of the state, the tax conforms with the National Banking Act.³ It has further been held under the act of Congress of February 10, 1868,⁴ permitting the state legislatures to direct the manner of taxing shares, that shares in national banks may be valued for taxation at an amount above their par value.⁵

¹ *Van Allen v. The Assessors*, 3 Wall. 573.

² *Van Allen v. The Assessors*, 3 Wall. 573, Chase, C. J., and Wayne and Swayne, JJ., dissenting. *Accord*, *Bradley v. People*, 4 Wall. 459; *National Bank v. Commonwealth*, 9 Wall. 353; in which last case the court held that a tax might, properly speaking, be a tax on shares, though it was collected from the bank instead of from the individual shareholders. See also *Mercantile Bank v. New York*, 121 U. S. 138; *People v. Home Ins. Co.*, 92 N. Y. 328; compare *Philadelphia Contributionship v. Commonwealth*, 98 Pa. St. 48.

³ *People v. The Commissioners*, 4 Wall. 244, affirming *Van Allen v. The Assessors*, *supra*. The fact that

the state, in the charters of two state banks, has disabled itself from taxing them, does not prevent the state from taxing shares in other state banks, and in national banks. *Lionberger v. Rouse*, 9 Wall. 468; compare *First National Bank v. Waters*, 19 Blatchf. 242.

⁴ *Ante*, § 5219 U. S. Rev. Stat.

⁵ *Hepburn v. The School Directors*, 23 Wall. 480; see *People v. Commissioners of Taxes*, 94 U. S. 415; *Straford National Bank v. Dover*, 58 N. H. 316.

But the provision in § 5219 of the U. S. Rev. Stat., that state taxation on the shares of any national banking association, shall not be at a greater rate than is assessed on other moneyed capital, has reference to the entire pro-

§ 485. Of great interest are the restrictions on the power of the state to tax corporations which arise from the essentially exclusive power of Congress to regulate commerce with foreign nations and among the states.¹ The power of a state to authorize railroads and other highways is unrestricted, and the disposition of revenues from them lies in its discretion.² A state may license and tax occupations extending beyond its borders, provided it does not discriminate in favor of similar occupations that are carried on entirely within its borders.³ But a state cannot impose a tax on the movement of persons or commodities from one state to another.⁴ A state tax on freight transported from state to state is void, as amounting to a regulation of commerce between the states; for, whenever a subject, over which a power regulative of commerce is asserted, is in its nature national or interstate, it may be said to require exclusive regulation by Congress; and the transportation of passengers

Restric-
tions on
state taxa-
tion arising
from the
power of
Congress to
regulate
commerce.

cess of assessment, and includes the valuation of the shares as well as the rate of percentage charged thereon. A New York statute which permits a person to deduct his just debts from the valuation of all his personal property, except from so much thereof as consists of national banking shares, taxes them at a greater rate than other moneyed capital, and is void as to them. *People v. Weaver*, 100 U. S. 539; *Supervisors v. Stanley*, 105 U. S. 305. See *Pelton v. National Bank*, 101 U. S. 143; *Cummings v. National Bank*, 101 U. S. 153.

The personal property of an insolvent national bank in the hands of a receiver is exempt from state taxation. *Rosenblatt v. Johnston*, 104 U. S. 462. A national bank may, on behalf of its shareholders, maintain a suit to enjoin the collection of a state tax unlawfully assessed on their shares. *Hills v. Exchange Bank*, 105 U. S. 319; *Evansville Bank v. Britton*, 105 U. S. 322;

Cummings v. National Bank, 101 U. S. 153; *National Albany Exchange Bank v. Wells*, 18 Blatchf. 478; *City National Bank v. Paducah*, 2 Flippin, 61. But see § 492*b*, note.

¹ See for the effect of these exclusive powers of Congress in restricting the police power of the states, *ante*, §§ 474*b*–474*d*.

² *Railroad Co. v. Maryland*, 21 Wall. 456.

³ *Machine Co. v. Gage*, 100 U. S. 676; *Osborne v. Mobile*, 16 Wall. 479. Compare *Ward v. Maryland*, 12 Wall. 418; *Erie Ry. Co. v. State*, 31 N. J. L. 531; *Jackson Mining Co. v. Auditor-General*, 32 Mich. 488.

⁴ *Crandall v. State of Nevada*, 6 Wall. 35; *Railroad Co. v. Maryland*, 21 Wall. 456. Compare *Moran v. New Orleans*, 112 U. S. 69; *Coe v. Errol*, 116 U. S. 517; *Pickard v. Pullman Southern Car Co.*, 117 U. S. 34.

or merchandise through a state is of this nature.¹ On the other hand, a state tax on the gross receipts of a railroad company is not such a regulation of interstate commerce as to be repugnant to the Constitution, even though the gross receipts are made up in part from freights received for the transportation of merchandise from the state laying the tax to another state, or for transportation from another state into the state laying the tax; nor is such a tax a tax on imports or exports.² And it is further held a state may tax the vehicles of commerce like other property owned by its citizens.³

A state cannot impose a tax on commodities by reason of their foreign origin; nor in any way discriminate in its tax laws against the products of other states brought within its boundaries.⁴ The power of congress to regulate commerce "continues until the commodity has ceased to be the subject of discriminating legislation by reason of its foreign character. That power protects it, even after it has entered the state, from any burden imposed by reason of its foreign origin. . . .

¹ Case of the State Freight Tax, 15 Wall. 233. But the court said that it recognized fully the power of a state to tax its own internal commerce, and the franchises, property, and business of its own corporations, provided interstate trade and commerce were not thereby embarrassed or restricted. *Ib.* Compare Passenger Cases, 7 How. 283; Delaware Railroad Tax, 18 Wall. 206; *Fargo v. Michigan*, 121 U. S. 230; *Philadelphia, etc. S. S. Co. v. Pennsylvania*, 122 U. S. 326.

² State Tax on Railway Gross Receipts, 15 Wall. 284. See *Ohio and Mississippi R. R. Co. v. Weber*, 96 Ill. 443. State Tax on Railway Gross Receipts, *supra*, is questioned in *Philadelphia, etc. S. S. Co. v. Pennsylvania*, *supra*.

Maryland granted to a railroad company a franchise to build a road from Baltimore to Washington, stipulating that the company should charge not

more than two and a half dollars per passenger, and that at the end of every six months the company should pay to the state one-fifth of the amount received for the transportation of passengers. *Held*, that such stipulation was not unconstitutional as being a restriction on free intercourse and traffic between the states, and that it differed from a tax or duty on the movements or operations of commerce between the states. *Railroad Co. v. Maryland*, 21 Wall. 456; compare *Osborne v. Mobile*, 16 Wall. 479.

³ *Wiggins Ferry Co. v. East St. Louis*, 107 U. S. 365; compare *Transportation Co. v. Wheeling*, 99 U. S. 273; Passenger Cases, opinion of McLean, J., 7 How. 283, 402; *Commonwealth v. Gloucester Ferry Co.*, 98 Pa. St. 105.

⁴ *Walling v. Michigan*, 116 U. S. 446.

The fact that congress has not seen fit to prescribe any specific rules to govern interstate commerce does not affect the question. Its inaction on this subject, when considered with reference to its legislation with respect to foreign commerce, is equivalent to a declaration that interstate commerce shall be free and untrammelled."¹

§ 486. In respect of its foreign and interstate business a telegraph company is, as an instrument of commerce, subject to the regulating power of Congress, and if it ^{Telegraph companies.} accepts the provisions of title sixty-five, of the Revised Statutes of the United States, it becomes a Federal agent in so far as the business of the Federal government is concerned. Accordingly, when such a company has accepted those provisions, state laws, in so far as they impose a specific tax on each message which the company transmits beyond the state, or on messages sent by a United States officer over its lines on public business, are unconstitutional.²

§ 487. It will be noticed that the restrictions so far discussed on the power of a state to tax corporations, depend on the relation that a state under the Constitution bears to the United States government, rather than on any special relations that a corporation bears to the state incorporating it, or to other states. These restrictions derive their importance in regard to corporations from the fact that enterprises of great magnitude, like the building and working of railroads and telegraphs extending through several states, are ordinarily undertaken by corporations, the means of single individuals rarely sufficing for the successful carrying out of such enterprises. On the other hand, the restrictions remaining for discussion on the power of a state to

¹ *Welton v. State of Missouri*, 91 U. S. 275, 282. See also *Weber v. Virginia*, 103 U. S. 344; *Guy v. Baltimore*, 100 U. S. 434; *Tiernan v. Rinker*, 102 U. S. 123; *Cook v. Pennsylvania*, 97 U. S. 566; *Higgins v. Three Hundred Casks of Lime*, 130 Mass. 1. Compare *Turner v. Maryland*, 107 U. S. 38.

tion of which many interesting questions are likely to arise.

² *Telegraph Co. v. Texas*, 105 U. S. 460. See *American Union Telegraph Co. v. Western Union Telegraph Co.*, 67 Ala. 26. Such a law would be unconstitutional, not only as being a regulation of interstate commerce, but also as interfering with a Federal agency.

Congress has now passed an interstate commerce bill, in the construc-

tax corporations, arise from special contractual relation between a corporation and the state incorporating it, and from the application of the rule that no man shall be deprived of his property without due process of law.

§ 488. In incorporating a corporation, a state legislature may exempt from taxation the corporate property for a specified time, or forever; and this exemption may be from taxation beyond a certain amount, or from any taxation whatsoever. Such an exemption, when made by the legislature at the time of incorporating the corporation, and when expressed in clear and unmistakable terms,¹ constitutes a contract between the corporation and the state, the obligation of which would be impaired by any subsequent state law at variance with its terms.² Thus, in 1845, the legislature of Ohio

Chartered
exemptions
from taxation.

¹ To sustain against a state a contract not to tax a corporation, the terms must be clear and unequivocal. *North Missouri Railroad v. Maguire*, 20 Wall. 46; *Memphis Gas Co. v. Shelby County*, 109 U. S. 398; *St. Louis v. Manufacturers' Savings Bank*, 49 Mo. 574. That a state has chartered a corporation without reserving the right to alter and repeal does not prevent the state from taxing the franchises and property of such corporation. *Providence Bank v. Billings*, 4 Pet. 519. See *Portland Bank v. Apthorp*, 12 Mass. 252; *Commonwealth v. Lancaster Savings Bank*, 123 Mass. 493.

² When a state in chartering a charitable corporation exempts its property from taxation, a subsequent law taxing its property is void. *Washington University v. Rouse*, 8 Wall. 439; *Home of the Friendless v. Rouse*, ib. 430; *University v. People*, 99 U. S. 309; *Asylum v. New Orleans*, 105 U. S. 362; *Mobile and S. H. R. R. Co. v. Kennerly*, 74 Ala. 566. The same is true of a railroad corporation. *Humphrey v. Pegues*, 16 Wall. 244; *Farrington v. Tennessee*, 95 U. S. 679;

Pacific Railroad Co. v. Maguire, 20 Wall. 36. And of other stock corporations; *Jefferson Branch Bank v. Skelly*, 1 Black, 436; *Franklin Branch Bank v. Ohio*, 1 Black, 474; acc. *Mobile and Ohio R. R. Co. v. Moseley*, 52 Miss. 127; *Atlantic and Gulf R. R. Co. v. Allen*, 15 Fla. 637; *Bank of Commerce v. McGowan*, 6 Lea (Tenn.), 703; *Neustadt v. Illinois Central R. R. Co.*, 31 Ill. 484. But these doctrines have not been universally acquiesced in by the state courts, or even by all the judges of the Federal Supreme Court. That a state cannot bargain away its taxing powers was held in *Mechanics and Traders' Bank v. Debolt*, 1 Ohio St. 591; *Toledo Bank v. Bond*, ib. 622; *Skelly v. Jefferson Branch Bank*, 9 Ohio St. 606; *Mott v. Pennsylvania R. R. Co.*, 30 Pa. St. 9. See *Brewster v. Hough*, 10 N. H. 138; *West Wisconsin R. R. Co. v. Supervisors*, 35 Wis. 257; *Washington University v. Rouse*, 8 Wall. 439, per Chase, C. J., Miller and Field, JJ., dissenting. Compare the remarks of Marshall, C. J., in *Providence Bank v. Billings*, 4 Pet.

chartered a bank, stipulating that the bank should pay a certain tax, which should be in lieu of all other taxes; in 1852 an act was passed, levying taxes on the bank to a greater amount, and this last act was held void as impairing the obligation of a contract.¹

§ 489. Exemptions from taxation constituting a contract on the part of the state not to tax, are held never to arise by implication;² and are construed narrowly in

Never arise
by implication.

519, 563, and the strong adverse criticism of this case in *Angell and Ames on Corp.* §§ 465-469.

¹ *Dodge v. Woolsey*, 18 How. 331; *Accord*, *State Bank of Ohio v. Knoop*, 16 How. 369. See *Gordon v. Appeal Tax Court*, 3 How. 133; *State v. Berry*, 2 Harrison (N. J.), 80. A charter exempting the property of a railroad company, and the shares therein from taxation, exempts not only the rolling stock and real estate, but also the franchise of the corporation; and a subsequent law taxing the franchise impairs the obligation of a contract, and is void. *Wilmington Railroad v. Reid*, 13 Wall. 264; *Raleigh and Gaston R. R. Co. v. Reid*, 13 Wall. 269; *Worth v. Wilmington, etc. R. R. Co.*, 89 N. C. 291; *Worth v. Petersburg R. R. Co.*, 89 N. C. 301. In *Tennessee v. Whitworth*, 117 U. S. 129, the exemption of "capital stock" from taxation was construed to exempt the shares in the hands of shareholders.

² A provision in an act consolidating two railroad companies, requiring the consolidated company to pay a tax of one-quarter per cent. on its stock, does not prevent the legislature from imposing further and different taxes. *Delaware Railroad Tax*, 18 Wall. 206. See also *People v. Commissioners of Texas*, 82 N. Y. 459.

The charter of a street railroad

company provided that the company should pay a license of \$30 for each car run by the company; subsequently the legislature raised the license to \$50. *Held*, that there was no contract to require only \$30. *Railway Co. v. Philadelphia*, 101 U. S. 528. The court said that even if this provision had constituted a contract, under its constitutional power reserved to alter and amend, the legislature could have imposed the additional license. *Ib.* *Acc.* *Johnson v. Philadelphia*, 60 Pa. St. 445; *Frankford and P. Pass'r Ry. Co. v. Philadelphia*, 58 Pa. St. 119. The grant to a corporation of a privilege to manufacture and vend gas in a city for a certain term of years, which places restrictions on the prices that may be demanded by the corporation, does not exempt the corporation from the imposition of a license tax. *Memphis Gas Co. v. Shelby County*, 109 U. S. 398.

When a corporation is chartered with the unconditional right to increase its capital stock (power to alter, etc., *not* reserved), the state cannot exact a bonus (not a tax) on the corporations increasing its stock. *Commonwealth v. Erie, etc. Trans. Co.*, 107 Pa. St. 112. But when a charter, which is subject to alteration and repeal, provides that the corporation shall not be taxed until its dividends amount to a certain per cent., the state may still

favor of the state.¹ Moreover, to give rise to such a contract there must be some consideration therefor from the corporation; as a statute passed subsequently to the creation of a corporation, providing that the corporation shall not be taxed beyond a certain rate, is a mere gratuity, and may be repealed by the state at any time.² So a statute of one state permitting a corporation of another state to exercise part of its franchises in the former state, and laying a tax on the corporation at the same time, does not preclude further taxation on the part of the former state.³ And an exemption from taxation in the nature of a "bounty" has been held repealable, even as to corporations formed subsequently to its passage and with a view to its provisions.⁴

§ 490. An exemption of the property and franchises of a corporation from taxation is a privilege pertaining to the corporation, which does not follow its property, and franchises into the hands of subsequent owners; unless subsequent owners succeed to the property and

Immunity
from taxa-
tion not
transfer-
able.

tax the corporation before that condition of affairs exists. *Commonwealth v. Fayette County R. R. Co.*, 55 Pa. St. 452. Compare § 461, *ante*, and § 497, note. See also cases in the following note.

¹ *Railroad Cos. v. Gaines*, 97 U. S. 697; *Railroad Co. v. Commissioners*, 103 U. S. 1; *Hoge v. Railroad Co.*, 99 U. S. 348; *Bailey v. Maguire*, 22 Wall. 215; *Morgan v. Louisiana*, 93 U. S. 217; *Roosevelt Hospital v. City of New York*, 84 N. Y. 108; *Academy v. Exeter*, 58 N. H. 306; *Tucker v. Ferguson*, 22 Wall. 527; *Memphis and L. R. R. Co. v. Railroad Commissioners*, 112 U. S. 609.

Exempting the capital stock and dividends from taxation does not exempt lands granted to the corporation by the state creating it. *Railroad Co. v. Loftin*, 98 U. S. 559; see *Railway Co. v. Loftin*, 105 U. S. 258. Where the purposes for which a corporation may hold property are specified in con-

nection with an exemption of its property from taxation, the exemption applies only to property acquired for such purposes. *Bank v. Tennessee*, 104 U. S. 493.

² *Christ Church v. County of Philadelphia*, 24 How. 300. An act of the legislature exempting property from taxation is not a "contract" unless there is a consideration for it, but a nude pact and revocable. *Tucker v. Ferguson*, 22 Wall. 527; *West Wisconsin R. R. Co. v. Supervisors*, 93 U. S. 595. But if the exemption be contained in an amendment to the charter accepted by the corporation, the exemption constitutes a contract binding on the state. *University v. People*, 99 U. S. 309; *Commonwealth v. Pottsville Water Co.*, 94 Pa. St. 516.

³ *Erie Railway Co. v. Pennsylvania*, 21 Wall. 492; *Home Insurance Co. v. City Council*, 93 U. S. 116.

⁴ *Salt Co. v. East Saginaw*, 13 Wall. 373.

franchises of the corporation under special authority from the state securing to them all the rights and privileges of the corporation.¹ Thus, upon the sale of the property and franchises of a railroad corporation under a mortgage, in terms covering the franchises of the corporation, immunity of the property of the corporation from taxation does not accompany the property in its transfer to the purchaser. The court held that the franchises of a railroad corporation are positive rights and privileges without which the road could not be successfully worked, and that immunity from taxation is not one of them. Franchises may pass to the purchaser as part of the property; immunity from taxation is personal, and incapable of transfer, without express statutory direction.² When a railroad comes into the possession of the state, whatever immunity from taxation may have existed in respect to it ceases; and will not pass to the grantee of the state, if the state at the time of taking possession is forbidden by the state constitution to grant immunity from taxation.³ And when by reason of restrictions in a state constitution it is incompetent for the legislature to make an original grant of exemption from taxation, it is also incompetent for the legislature to provide that the assignee of a rail-

¹ See *Tennessee v. Whitworth*, 117 U. S. 139; *Nichols v. New Haven and N. Co.*, 42 Conn. 103. Exemption from taxation may pass to a corporation which purchases the road of another under a statute providing that "all rights" as to a line of railway which "are and have been legally vested" in one corporation shall pass to the corporation purchasing its road. *Atlantic and Gulf R. R. Co. v. Allen*, 15 Fla. 637. A mortgage by a railroad company of its charter, rights, privileges, and franchises, made in pursuance of authority to mortgage "its charter and works," does not pass an exemption from taxation to the corporation formed out of the bondholders after foreclosure. *Memphis and*

L. R. R. Co. v. Railroad Commissioners, 112 U. S. 609.

² *Morgan v. Louisiana*, 93 U. S. 217; followed in *Louisville and Nashville R. R. Co. v. Palmes*, 109 U. S. 244; *Chesapeake and O. R'y Co. v. Miller*, 114 U. S. 176; see *Railroad Cos. v. Gaines*, 97 U. S. 697; *State v. Morgan*, 28 La. Ann. 482; *Railroad Co. v. County of Hamblen*, 102 U. S. 273; *Humphrey v. Pegues*, 16 Wall. 244; *Wilson v. Gaines*, 103 U. S. 417; *Memphis and L. R. R. Co. v. Railroad Commissioners*, 112 U. S. 609; compare *City of Bridgeport v. New York and N. H. R. R. Co.*, 36 Conn. 255, 266; and *Truckee Turnpike Co. v. Campbell*, 44 Cal. 89.

³ *Trask v. Maguire*, 18 Wall. 391.

road company which had enjoyed a personal non-assignable immunity from taxation shall enjoy the immunity possessed by his assignor.¹ This reasoning was afterwards followed in the case of a consolidation creating a new corporation; and it was held that the new corporation could not have received immunity from taxation because of an amendment to the state constitution in force at the time of the consolidation forbidding the exemption of corporations from taxation.²

§ 491. Some of the most interesting questions respecting chartered immunity from taxation have arisen upon the consolidation of corporations; and in solving these questions the Supreme Court of the United States has strongly exemplified the doctrine that the intent of the legislature to exempt the property of a corporation from taxation must be explicit. An early case is *Philadelphia and Wilmington Railway Co. v. Maryland*,³ which was the case of a railroad company formed by the union of several companies chartered by different states. One of the original companies had been chartered by Maryland, and its charter contained no exemption from taxation. The court held that the property of the consolidated company in Maryland could be taxed by that state, although the charter of another of the original companies, given by another state, contained an exemption from taxation.⁴ So, where one railroad company was merged

¹ *Louisville and Nashville R. R. Co. v. Palmes*, 109 U. S. 244.

² *St. Louis, I. M. and S. R'y Co. v. Berry*, 113 U. S. 465.

³ 10 How. 376.

⁴ Two acts of Delaware and Maryland authorized the consolidation of two railroad companies, one in Delaware and one in Maryland. Both acts contained a provision whereby the shareholders of the two companies should, when consolidated, enjoy all the rights and privileges, and exercise all the powers vested in either company. It was held that the purpose of the two provisions was to vest in the new company the rights and privileges

which the original companies had previously enjoyed under their respective charters; the rights and privileges in Maryland which the Maryland company had there enjoyed, and in Delaware the rights and privileges which the Delaware company had there enjoyed, and that it was not the purpose to transfer to either state and enforce therein the legislation of the other. And, therefore, since a provision in the charter of the original Maryland corporation exempting its shares from taxation, exempted them only in Maryland, the privilege of the new company in this matter only extended to an exemption in that state and did not

in another created by the same state, which latter company became invested with all the property, rights, and privileges of the former, it was held that an exemption from taxation in the charter of the latter company did not, in the absence of express words or necessary intendment, extend to the property of the former railroad acquired through the consolidation.¹ A consolidated company acquires no greater immunities from taxation than the constituent companies had prior to the consolidation, and holds their immunities distributively; that is to say, whatever privileges and advantages either of the former companies possessed, inure to the benefit of the new company to the extent of the road occupied by each of the former companies respectively at the time of the consolidation.² And when two corporations subjected to a certain special tax, with immunity from other taxation, are consolidated into a new corporation under such conditions as to render the special tax impossible, the new corporation is not entitled to immunity from general taxation.³

§ 492. The rule that no man shall be deprived of his property without due process of law applies to taxation; but a mode of procedure may be "due process of law" ^{Taxation.} "Due process of law."

exempt its shares from taxation in Delaware. *Delaware Railroad Tax*, 18 Wall. 206. Two corporations enjoying respectively certain immunities from taxation were consolidated by a statute passed after the passage of a general law reserving generally the right to the state to withdraw corporate franchises granted by subsequent charters unless expressly negatived in the charter; the effect of the consolidation was to dissolve the two corporations and create a new one; it was held the consolidated corporation was subject to taxation. *Railroad Co. v. Georgia*, 98 U. S. 359.

¹ *Chesapeake, etc. R. R. Co. v. Virginia*, 94 U. S. 718.

² *Tomlinson v. Branch*, 15 Wall. 460; see *Central Railroad, etc. Co. v. Georgia*, 92 U. S. 665; *State v. Com-*

missioners, 37 N. J. L. 240; *Tennessee v. Whitworth*, 117 U. S. 139. When a new corporation is formed out of two or more previously existing corporations, and by the act creating it is to have the powers, privileges, and immunities possessed by each of the corporations whose union constitutes the new corporation, the new corporation will have the privileges, powers, and immunities which they all (*i. e.*, every one of them) had; and will not have those powers, privileges, and immunities which some had and some did not. This construction was put on a consolidating act in regard to exemption from taxation; the former charters, moreover, were subject to alteration and repeal. *State v. Maine Central R. R. Co.*, 66 Maine, 488, 514.

Railroad Co. v. Maine, 96 U. S. 499.

in matters of taxation, which would not be "due process of law" in other proceedings. "Taxes have not, as a general rule, in this country since its independence, nor in England before that time, been collected by regular judicial proceedings. The necessities of government, the nature of the duty to be performed, and the customary usages of the people, have established a different procedure, which, in regard to that matter, is, and always has been, due process of law."¹ Accordingly, at least as regards taxation, the phrase does not necessarily imply a regular proceeding in a court of justice, or after the manner of courts of justice.² In delivering the opinion of the court in *Davidson v. New Orleans*,³ Justice Miller said in regard to the term: "Apart from the eminent risk of a failure to give any definition which would be at once perspicuous, comprehensive, and satisfactory, there is wisdom we think in the ascertaining of the intent and application of such an important phrase in the Federal Constitution by the gradual process of judicial inclusion and exclusion, as the cases presented for decision shall require, with the reasoning on which such decisions may be founded. This court is, after an experience of nearly a century, still engaged in defining the obligation of contracts, the regulation of commerce, and other powers conferred on the Federal government, or limitations imposed upon the states." As contributory to this process we hold "that whenever by the laws of a state, or by state authority, a tax, assessment, servitude, or other burden, is imposed upon property for the public use, whether it be for the whole state, or for some more limited portion of the community, and these laws provide for a mode of confirming or contesting the charge thus imposed, in the ordinary courts of justice, with such notice to the person, or such proceeding in regard to the property as is appropriate to the nature of the case, the judgment in such proceedings cannot be said to deprive the owner of his property without due process of law, however obnoxious it may be to other objections."⁴

¹ *Kelly v. Pittsburgh*, 104 U. S. 78, 80; opinion of court per Miller, J.
² *Davidson v. New Orleans*, 96 U. S. 97, citing *Murray's Lessee v. Hoboken Land Co.*, *supra*.
³ 96 U. S. 97, 104.
⁴ See also *Kentucky R. R. Tax Cases*, 115 U. S. 321.

§ 492a. Giving the opinion of the court in *Hagar v. Reclamation District* (after quoting approvingly from *Davidson v. New Orleans*), Justice Field said: "It is sufficient to observe here that by 'due process' is meant one which, following the forms of law, is appropriate to the case, and just to the parties to be affected. It must be pursued in the ordinary mode prescribed by the law; it must be adapted to the end to be attained; and wherever it is necessary for the protection of the parties, it must give them an opportunity to be heard respecting the justice of the judgment sought. The clause in question means, therefore, there can be no proceeding against life, liberty, or property which may result in the deprivation of either, without the observance of those general rules established in our system of jurisprudence for the security of private rights.¹ Unless restrained by provisions of the Federal Constitution, the power of the state, as to the mode, form, and extent of taxation, is unlimited, where the subjects to which it applies are within her jurisdiction."²

"Of the different kinds of taxes which the state may impose, there is a vast number of which, from their nature, no notice can be given the taxpayer, nor would notice be of any possible advantage to him, such as poll taxes, license taxes (not dependent upon the extent of his business), and generally, specific taxes on things, or persons, or occupations. In such cases the legislature, in authorizing the tax, fixes its amount, and that is the end of the matter. If the tax be not paid, the property of the delinquent may be sold, and he be thus deprived of his property. Yet there can be no question that the proceeding is due process of law, as there is no inquiry into the weight of evidence, or other element of a judicial nature, and nothing could be changed by hearing the tax-payer. No right of his is, therefore, invaded. . . .

"But where a tax is levied on property, not specifically, but according to its value, to be ascertained by assessors appointed for that purpose upon such evidence as they may obtain, a different principle comes in. The officers in estimating the value act judicially; and in most of the states provision is made for-

¹ Citing *Hurtado v. California*, 110 U. S. 516, 536.

² Quoted from *State Tax on Foreign Held Bonds*, 15 Wall. 300, 319.

the correction of errors committed by them, through boards of revision or equalization, sitting at designated periods provided by law to hear complaints respecting the justice of the assessments. The law in prescribing the time when such complaints will be heard, gives all the notice required, and the proceeding by which the valuation is determined, though it may be followed, if the tax be not paid, by a sale of the delinquent's property, is due process of law."¹

§ 492b. In order to obtain the aid of a court of equity to restrain the collection of a tax, the case must be brought within some of the recognized foundations of equity jurisdiction, and mere error, or excess in valuation, or hardship or injustice of the law, or any grievance which can be remedied by a court of law, either before or after payment of the tax, will not warrant a court of equity to interpose by injunction to stay the collection of a tax.² And as a general rule, the owner of taxable property who would enjoin the collection of a tax thereon, must first pay or tender so much as is due.³

¹ *Hagar v. Reclamation District*, 111 U. S. 701, 709, 710. (There is appended at the end of this case a note of the legislation of the colonies before the Revolution, and of the states since, giving the taxpayer the right to be heard before the assessment becomes final.) Compare *Porter v. Rockford*, etc. R. R. Co., 76 Ill. 561; *Railroad Tax Cases*, 13 Fed. Rep. 722.

² *State Railroad Tax Cases*, 92 U. S. 575; see *Union Pacific Ry. Co. v. Cheyenne*, 113 U. S. 516; *Allen v. Baltimore and Ohio R. R. Co.*, 114 U. S. 311. One of the reasons why a court should not thus interfere, as it would in a matter between individuals, is that it has no power to apportion the tax, or make a new assessment, or order a new assessment to be made by the proper officers of the state. The levy of taxes is not a judicial function,

but by the constitutions of all the states, and by the theory of our English origin, is exclusively legislative. If there is an over-valuation of the franchise, or of the capital stock, or of both, it is an error of judgment in the officers to whose judgment the law confided that matter; and it does not lie with a court to substitute its own judgment for that of the tribunal expressly created for that purpose. *Ib.* Compare *Wright v. Southwestern R. R. Co.*, 64 Ga. 783; *Southwestern R. R. Co. v. Wright*, 68 Ga. 311.

³ *National Bank v. Kimball*, 103 U. S. 732; compare *Supervisors v. Stanley*, 105 U. S. 305. A bank cannot enjoin a tax collector from selling the shares of individual shareholders. *Waseca County Bank v. McKenna*, 32 Minn. 468. But see § 484, note.

§ 493. The discussion of the powers which a state has over corporations by virtue of its police power (in the broadest sense), would be incomplete without mentioning the distinction taken in many cases between "rights" and "remedies." It has been, for instance, decided that the abolishment of imprisonment for debt, or distress for rent, even as to debts already contracted or leases already in force, is not unconstitutional as impairing the obligation of a contract, because such a law is held to operate only as a modification of the remedy.¹ These cases have been questioned,² and indeed the distinction between a right and a remedy is probably of comparatively recent growth. Going back to early periods of legal history we find that what are now regarded as the substantial rights of persons were simple and easy of determination, while the more difficult, but equally important, questions were as to the proper means of enforcing these rights. This is illustrated by the extraordinary prominence of the law of distress in the Brehon (old Irish) and Salic systems.³ At Rome, moreover, the right to bring a certain *actio* was not distinguished, as at present, from the rights which by means of that *actio* were sought to be enforced.⁴ Still, the law of procedure is in most respects to-day readily distinguishable from the law regulating material rights, and with reference to our present legal notions the distinction on principle may be sufficiently justifiable, if not so historically.⁵ Besides, the power to regu-

Distinction
between
"rights"
and "reme-
dies."

¹ *Sturges v. Crowninshield*, 4 Wheat. 122; *Mason v. Haile*, 12 Wheat. 370; *Penniman's Case*, 103 U. S. 714; *Van Rensselaer v. Snyder*, 13 N. Y. 299; *Conkey v. Hart*, 14 N. Y. 22.

² "Any law which in its operation amounts to a denial or obstruction to the rights accruing by contract, though professing to act only on the remedy, is directly obnoxious to the provision of the Constitution." *Pritchard v. Norton*, 106 U. S. 124, 132; see *McCracken v. Hayward*, 2 How. 608, 612; *Gunn v. Barry*, 15 Wall. 615; *Edwards v. Kerzey*, 96 U. S. 595, 607. The last two cases held that in-

creased exemptions under a new homestead act affecting the remedy under contracts already entered into were unconstitutional. See also *Louisiana v. New Orleans*, 102 U. S. 206.

³ See *Maine's Early History of Institutions*.

⁴ See, generally, Windschied, *Die Römische Actio*.

⁵ See *United States v. Union Pacific R. R. Co.*, 98 U. S. 569, 608. A reduction in the time prescribed by the statute of limitations in force when the right of action accrued is not unconstitutional, provided a reasonable time be left for the commencement of

late procedure may perhaps be regarded as a portion of the police power of the state of which a surrender could never be presumed.¹

§ 494. A late statement of the general law on this subject may be found in *Penniman's Case*,² where Justice Woods said, giving the opinion of the Supreme Court of the United States: "The general doctrine of this court on this subject may be thus stated: in modes of proceeding and forms to enforce the contract the legislature has the control, and may enlarge, limit, or alter them, provided it does not deny a remedy or so embarrass it with conditions or restrictions as seriously to impair the value of the right."³ It would seem, however, that when a new remedy is authorized after a contract has been made, such remedy may be wholly taken away by the legislature before any vested rights have been acquired under it; for such remedy could have formed no part of the contract as made. But if the creditor proceeds, and acquires any vested rights under the new remedy, it may then be incompetent for the legislature by repealing the new remedy to affect his rights.⁴

§ 495. In creating a corporation the legislature may impose upon it, and upon parties dealing with it, such restrictions as the legislature may deem proper in regard to subjecting its assets to the discharge of its obligations; and, further, may provide that any one of the usual remedies of creditors shall in certain cases be withheld.⁵ And after a corporation has been incorporated, a statute which prescribes a mode of judicial service on the corporation different from that provided for in its charter affects only the remedy and is constitutional.⁶ Likewise provisions in the charter of a railroad company regulating

a suit before the bar takes effect. generally, *Virginia Coupon Cases*, 114
Terry v. Anderson, 95 U. S. 628; U. S. 270.

compare *Blount v. Windley*, 95 U. S. 173. * *Memphis v. United States*, 97 U. S. 293; *South Carolina v. Gaillard*, 101 U. S. 438.

¹ See *Railroad Co. v. Hecht*, 95 U. S. 168.

² 103 U. S. 714, 720.

³ See also *Tennessee v. Sneed*, 96 U. S. 69; *Crawford v. Branch Bank* 467.

of *Mobile*, 7 How. 279; *Antoni v. Greenhow*, 107 U. S. 769. Compare, ⁶ *Railroad Co. v. Hecht*, 95 U. S. 168.

the manner of taking land ;¹ or a summary remedy against defaulting stockholders given to a corporation by its enabling act, may be changed by subsequent legislation.²

§ 496. Having discussed the powers which a state has over corporations and their property by virtue of eminent domain, police, and taxing powers ; by virtue, that is, of powers inherent in the state as the political superior of the corporation, the exercise of which is not incompatible with the concurrent legal relations between the state and the corporation occasioned by the implied contract between them ; we come now to consider the further powers of the state over corporations when, by reserving the right to alter and amend or repeal the charter or enabling act of the corporation, the state prevents such charter or enabling act from impliedly creating as between itself and the corporation a contract within the purview of the Federal Constitution.³ The state occupies towards the corporation the position of lawgiver,

The power reserved to alter and repeal.

¹ *Mississippi R'y Co. v. McDonald*, 12 Heisk. (Tenn.) 54 ; *Gowen v. Penobscot R. R. Co.*, 44 Me. 140 ; *Chatteroi Ry. Co. v. Kinner*, 81 Ky. 221 ; see *Baltimore and Susquehanna R. R. Co. v. Nesbit*, 10 How. 395.

² *Ex parte North East and S. W. Ala. R. R. Co.*, 37 Ala. 679. The legislature can alter the mode of assessing banks. *Bank of Republic v. County of Hamilton*, 21 Ill. 53 ; see *Reapers' Bank v. Willard*, 24 Ill. 433. A statute authorizing the sale of its road for payment of the debts of the corporation is constitutional, even if the right to alter and repeal is not reserved. *Louisville, etc. Turnpike Co. v. Ballard*, 2 Metc. (Ky.) 165.

Even when the power to alter and repeal the charter is not reserved, a state may constitutionally provide that a state officer may file a petition to have unsound insurance companies wound up. This is a valid exercise by the state of its unalienable police power,

and does not impair the obligation of the contract between the corporation and the state, nor deprive shareholders of their vested rights. *Ward v. Farwell*, 97 Ill. 593 ; *Chicago Life Ins. Co. v. Auditor*, 101 Ill. 82. See *Forstall v. Consolidated Association*, 34 La. Ann. 770 ; *Rockover v. Life Association*, 77 Va. 85.

³ "The reserved power of amendment and repeal is not anything more than the legislature would have had without a reservation, if statutes of incorporation had been held to be possessed of the ordinary amendable and repealable qualities of other statutes." *Ashuelot R. R. Co. v. Elliot*, 58 N. H. 451, 454. The right to alter and repeal may be reserved in a general statute so as to apply to charters subsequently granted. *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32 ; *Roxbury v. Boston and P. R. R. Co.*, 6 Cush. (Mass.) 424.

from whom emanate most of the rules of law contained in the constitution of the corporation. It is held to contract with the corporation not to alter these rules, thus agreeing that acts in respect of the corporate enterprise shall always have a certain legal effect. This, as we have seen,¹ is the only contract ordinarily existing between the corporation and the state; and if the state reserves the right to alter or repeal these rules of law, that reservation prevents the existence of this contract.

§ 497. Accordingly, when the state reserves this power, the charter or enabling act of the corporation, as between the state and the corporation, subsists simply as a rule for conduct, as law properly speaking, which, like other law, may be altered or repealed at the will of the legislature, provided the obligation of no contract is thereby impaired, and no one is deprived of his property without due process of law. No one has any property or vested right in a rule of law, except in so far as the rule has manifested itself in legal relations between himself and others who are within the scope of its operation; and, accordingly, provided legal relations already existing are not affected, the law may be changed at the will of the legislature.² As Chief Justice Waite said, in *Munn v. Illinois*:³ "A mere common law regulation of trade or business may be changed by statute. A person has no property, no vested interest, in any rule of the common law. That is only one of the forms of municipal law, and is no more sacred than any other. Rights of property which have been created by the common law cannot be taken away without due process; but the law itself, as a rule of conduct, may be changed at the will, or even at the whim of the legislature, unless prevented by constitutional limitations. Indeed, the great office of statutes is to remedy defects in the common law as they are developed, and to adapt it to the changes of time and circumstances."⁴

¹ § 450.

² When a state reserves the unconditional right to alter and repeal, the question whether an amendment is wise, consistent with public interests and the prosperity of the company, is for the legislature, not for the courts.

American Coal Co. v. Consolidation Coal Co., 46 Md. 15.

³ 94 U. S. 113, 134, affirming S. C., 69 Ill. 80.

⁴ A railroad company was incorporated, its charter being subject to alteration and repeal. Subsequently the

§ 498. But the charter of a corporation, or the enabling statute and articles of association filed in pursuance thereof,

state legislature amended the charter by exempting the property of the corporation from taxation. After the passage of this amendment, the people of the state adopted a new constitution, one of the provisions of which required corporations to be taxed; and, carrying out this provision, the legislature levied a tax on the property of said corporation. The tax was held constitutional, the Supreme Court saying, per Field, J. . . "The original corporators, or subsequent stockholders, took their interest with knowledge of the existence of this power, and of the possibility of its exercise at any time in the discretion of the legislature. . . . The reservation affects the entire relation between the state and the corporation, and places under legislative control all rights, privileges, and immunities derived by its charter directly from the state. Rights acquired by third parties, and which have become vested under the charter, in the legitimate exercise of its powers, stand upon a different footing; but of such rights it is unnecessary to speak here. The state only asserts in the present case the power under the reservation to modify its own contract [?] with the corporators; it does not contend for a power to revoke the contracts of the corporation with other parties, or to impair any vested rights thereby acquired." *Tomlinson v. Jessup*, 15 Wall. 454, 458. *Acc. Union Improvement Co. v. Commonwealth*, 69 Pa. St. 140.

A bridge company accepted from Congress the right to build a bridge across navigable waters, on condition that such right or franchise might be revoked, or alterations required in the

bridge at any time, if the bridge should be found detrimental to navigation. *Held*, that this condition was an essential element of the grant, and that the company, in accepting the privileges, assumed all risks of loss from the exercise of the power Congress had reserved; and that Congress might require alterations in the bridge without incurring for the United States liability to pay for them. *Bridge Co. v. United States*, 105 U. S. 470.

The constitution of California of 1849 provided that corporations might be formed under general laws, but should not be created by special act, except for municipal purposes; and that all general laws and special acts passed pursuant to this provision might be altered from time to time or repealed. The legislature afterwards enacted a general law for the formation of corporations for supplying cities and counties with water, which provided that the rates to be charged for water should be fixed by a board of commissioners to be appointed partly by the corporations and partly by the municipal authorities. Subsequently the constitution and laws of California were changed so as to take away from water companies organized under the old constitution and laws the power to appoint members of the boards of commissioners, and give to the municipal authorities the sole power to fix the rates for water. It was held that these changes violated no provision of the Federal Constitution, and that to vest such sole authority in the municipal authorities was within the legislative power. *Spring Valley Water Works v. Schottler*, 110 U. S. 347.

embody the terms of a contract between the corporators. This contract, however, is subject to the reserved power in the state to alter or repeal it: for it is a contract which is not only sanctioned by, but embodied in laws which the state has reserved the right to alter and repeal. Consequently, the legal relations among the corporators, in so far as they are occasioned solely by this contract, may be changed at the will of the state, without thereby impairing the obligation of the contract or depriving any one of "vested rights." The obligation of a contract consists in the rules of law which manifest themselves in legal relations between the parties to it;¹ and, in this instance, one of these very rules would be that the state might change or repeal any of the rules of law constituting this obligation; might change, that is, any of these legal relations. It is accordingly implied in the agreement of the corporators among themselves, that in so far as their legal relations are occasioned solely by their contract embodied in the constitution of the corporation, they may be altered at the will of the state. The obligation of this contract, then, consists *either* in the rules of law manifesting themselves in legal relations upon the execution of the contract, *or* in those rules as modified by subsequent legislation and such other rules as the state changing the constitution of the corporation may make.² Consequently, the state by changing the corporate constitution does not impair the obligation of this contract.³

¹ "The laws which exist at the time and place of the making of a contract, and where it is to be performed, enter into it and form part of it. This embraces alike those which affect its validity, construction, discharge, and enforcement. . . . The obligation of a contract is the law which binds the parties to it to perform their agreement." *Walker v. Whitehead*, 16 Wall. 314, 317, 318. See *Von Hoffman v. City of Quincy*, 4 Wall. 550; *Louisiana v. New Orleans*, 102 U. S. 206. Compare *Connecticut Mutual*

Life Ins. Co. v. Cushman, 108 U. S. 51.

² Compare *Supreme Commandery v. Ainsworth*, 71 Ala. 436, 450.

³ To the stock of a railroad corporation, whose charter was subject to alteration and repeal, a city subscribed, having the right to appoint a certain number of the directors of the railroad. Individuals also subscribed, but did not pay their subscriptions. Some years later the legislature authorized the city to appoint a greater number of directors; and the legislation was held

§ 499. Although the state may change the legal relations arising solely from the contract of the corporators embodied in the corporate constitution, it by no means follows that the state may change any and all legal relations subsisting in respect of the corporate enterprise. The contract embodied in the constitution is an act which itself occasions legal relations among the parties to it; and it is only the legal relations which arise solely from this contract as a contract that the state may change. The constitution of a corporation, besides embodying a contract between the corporators, contains rules of law which will manifest themselves in legal relations upon the doing of other and further acts in respect of the corporate enterprise; and the legal relations which are not occasioned solely by the contract embodied in the constitution, but which arise only upon the doing of other and further acts which bring the actors within the operation of that constitution regarded as law, the state cannot change. In respect of such acts, the state may only provide what legal relations they shall occasion in the future; but the acts having been done, no constitutional legislation can alter the legal relations which they have occasioned. As Strong, J., said in the *Sinking Fund Cases*,¹ the power reserved by a legislature to alter and repeal the charter of a corporation, "is one over the act itself, not over anything that may have lawfully been done under the act before its repeal or alteration. It is only by great confusion of things essentially distinct, that this power can be construed as applicable to a contract made after the corporation came into existence."² The following

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constitutional under the reserved power to alter and amend. *Miller v. State*, 15 Wall. 478; *Bradley and Field, JJ.*, dissented on the ground that this was a modification of a contract outside of the charter. See also *Close v. Greenwood Cemetery*, 107 U. S. 466; *Spring Valley Water Works v. San Francisco*, 61 Cal. 3; *Chincleclamouche Lumber Co. v. Commonwealth*, 100 Pa. St. 438, 444.

¹ 99 U. S. 700, 740.

² See *Oldtown, etc. R. R. Co. v. Veazie*, 39 Me. 571.

The reservation of the right to alter and repeal does not authorize the legislature to do a judicial act, such as foreclosing a mortgage by legislation cutting off the mortgagor's right to redeem (the mortgagor being a corporation with a charter subject to alteration and repeal). *Ashuelot R. R. Co. v. Eliot*, 58 N. H. 451.

passage from the opinion of Chief Justice Waite in the same case, may also be quoted: "Whatever rules Congress might have prescribed in the original charter for the government of the corporation in the administration of its affairs, it retained the power to establish by amendment.¹ In so doing, it cannot undo what has already been done, and it cannot unmake contracts that have already been made; but it may provide for what shall be done in the future, and may direct what preparation shall be made for the due performance of contracts already entered into. It might originally have prevented the borrowing of money, or it might have said that no bonded debt should be created without ample provision by sinking fund to meet it at maturity. Not having done so at first, it cannot now by direct legislation vacate mortgages already made under the powers originally granted, nor release debts already contracted. A prohibition now against contracting debts will not avoid debts already incurred. . . . All such legislation will be confined in its operation to the future."²

§ 500. For further illustration of the application of these principles let us suppose a corporation formed under a general enabling act (or with a special charter, this is immaterial); the state reserving the right to amend or repeal the enabling act. Let us suppose that the shareholders under this enabling act are not personally liable for the corporate debts after they have fully paid their subscriptions. Here the state may alter the enabling act so as to make the shareholders liable personally for all debts contracted by the corporation after such amendment;³ but not so as to make them liable for debts contracted before such amendment, as such retroactive legislation would (a) impair the obligation of a contract, and (b) deprive shareholders of their property without due process of law. To change the legal effect of a contract so as to impose additional burdens on the person already liable thereunder, impairs its obligation, for constitutional provisions exist as much for the protection of debtors

¹ Quoted in *Spring Valley Water Works v. Schottler*, 110 U. S. 347, 700, 721. See also *Close v. Glenwood Cemetery*, 107 U. S. 466.

353.

³ *Sherman v. Smith*, 1 Black, 587.

² *Sinking Fund Cases*, 99 U. S.

as of creditors.¹ The contract of which the obligation is impaired by making shareholders liable for debts already contracted, is the contract by which the indebtedness was incurred. Upon the making of this contract, which was not embodied in the charter or enabling act of the corporation, and so subject to alteration, legal relations arose in respect of the corporate enterprise between shareholders and creditors; and one of the rights of shareholders occasioned by the contract was that they should not be liable thereunder beyond the extent of their interest in the corporate funds. Consequently, imposing increased liability on the shareholders in respect of this contract would impair (alter) its obligation. In the second place, it is clear that the imposing of increased liability on the shareholders would give a creditor a right against them which he had not when the contract was made; and as every right implies a corresponding liability or duty, which in its turn (at least in a case of this nature) implies the giving up of a right, such amendment would deprive a person of a right, *i. e.*, of property without due process of law.²

§ 501. On the other hand, since the charter or enabling act of the corporation, when the right to alter and repeal is reserved, is to be regarded as between the state and the corporation only as law, it is clear that the corporation has no vested or contract

¹ "The objection to a law on the ground of its impairing the obligation of a contract, can never depend on the extent of the change which the law effects in it. Any deviation from its terms, by postponing or accelerating the period of performance which it prescribes, imposing conditions not expressed in the contract, or dispensing with the performance of those which are, however minute or apparently immaterial in their effect upon the contract of the parties, impairs its obligation." Washington, J., in *Green v. Biddle*, 8 Wheat. 1, 84.

² "Whatever modification of the liability of stockholders in banks may be legally made that shall operate upon future stockholders, or upon the

present stockholders prospectively, no constitutional legislation can operate to impose retrospectively increased personal liabilities upon the stockholders." Dewey, J., in *Commonwealth v. Cochituate Bank*, 3 Allen, 42, 44. It is held, however, that a general banking law is not unconstitutional in its application to corporations already in existence, because it provides that the original shareholders shall remain liable to the extent of their stock until it has been fully paid up, notwithstanding they may have transferred it. Such a provision is merely regulative of the transfers, and is such as was competent for the state to pass. *Marr v. Bank of West Tennessee*, 4 Lea (Tenn.), 578.

right to have the charter or enabling act remain unchanged so that in the future the corporation may continue to acquire by similar acts the same rights. The state may certainly impose individual liability on the shareholders as to future debts because of the concurrence of three reasons: first, as between the state and the corporation the enabling act embodied no contract; secondly, in so far as the enabling act embodied the contract among the corporators, it embodied a contract the terms of which by the implied assent of the parties thereto could be changed at the will of the state: thirdly, the supposed change being as to future indebtedness only, *ex hypothesi* no other contract had been entered into, the obligation of which would be impaired by the supposed legislation. It seems clear, however, that even as to future indebtedness, the state cannot impose increased liability on the shareholders, if the state has not reserved the right to alter and repeal; for such change would (a) impair the obligation of the contract between the state and the corporation, and (b) that of the contract among the corporators, which, in this instance, was not made with the implied consent that it might be changed at the will of the state.¹

On the other hand, when by the enabling act which the state reserves the right to alter and amend, the shareholders are individually liable for corporate debts, it is clear that the state cannot repeal this personal liability so as to affect the security of existing debts, without impairing the obligation of the contract between the creditor and the corporation;² and it hardly requires statement, that the state may repeal this personal liability as to debts not yet contracted.³

¹ *Ireland v. Palestine Co.*, 19 Ohio St. 369, 372; *limiting Palestine Co. v. Wooden*, 13 Ohio St. 395. *Contra*, *Gray v. Coffin*, 9 Cush. 192; *Coffin v. Rich*, 45 Me. 507; *Stanley v. Stanley*, 26 Me. 191. Compare *Longley v. Little*, 26 Me. 162; *Wheeler v. Frontier Bank*, 23 Me. 308; *Commonwealth v. Cochituate Bank*, 3 Allen, 42. In these Maine cases the right to amend seems to have been reserved to the state.

² *Hawthorne v. Calef*, 2 Wall. 22; *Corning v. McCullough*, 1 N. Y. 47; *Provident Savings Institution v. Jackson Skating Rink*, 52 Mo. 552; *St. Louis R'y Supplies Co. v. Harbine*, 2 Mo. App. 134; *Grand Rapids S'v'gs B'k v. Warren*, 52 Mich. 557; but compare *Woodhouse v. Commonwealth Ins. Co.*, 54 Pa. St. 307.

³ Compare *Curran v. Arkansas*, 15 How. 304, § 507.

§ 502. The question arises whether there are no limits besides those already discussed on the power of the state to change the constitution of a corporation when it has reserved the right to do so. It has been pointed out,¹ that when the charter of a corporation embodies a contract between the corporation and the state, the state through such contract acquires certain rights and powers over such funds of the corporators as become corporate property, powers which it would have been unconstitutional for the state to exercise, had the corporators not accepted the charter. The rights thus acquired by the state may be summed up, as the right, in so far as the interests of the public are concerned, either to compel the corporation to fulfil the purposes of its incorporation, or, if the state sees fit, to forfeit the franchises of the corporation. When, however, a corporation is formed under an enabling statute or accepts a charter, which the state reserves the right to alter or repeal, what is the limit to the right of the state to alter such statute, and then either compel the corporation to fulfil its altered objects of incorporation, or forfeit the franchises of the corporation for its failure to do so? As we have seen, there is no contract in such a case between the state and the corporation, for the state agrees to nothing. The corporators, however, assume the duty towards the public to fulfil the purposes of their incorporation, as far as the public may be interested in the fulfilment of such purposes, and this duty the state may enforce,² or, at its option, forfeit the franchises of the

Further
limits on
the re-
served
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¹ § 456.

² The assumption by the corporators of a duty towards the public does not imply any contractual relations between the corporation and the state. Every member of a community is affected with duties towards it, and by changing his occupation he usually assumes duties with which he was not affected prior to the change. Duties to the public are mostly negative, and may be summed up in the maxim, *Sic utere tuo ut alienum non lædas*, but in the case of a (private) corporation in-

corporated for a public purpose its duties towards the public may be positive. The point to be regarded is that the state does not contract, but simply passes a law, expressly reserving the right to alter or repeal. Davis, P. J., says in *People v. New York Central and H. R. R. Co.*, 28 Hun, 543: "The power of the state to compel a railroad company by mandamus to perform its duties, rests as firmly on the ground that that duty is a public trust, which having been conferred by the state, and accepted by the corpora-

corporation. But in these respects, and especially in respect of enforcing the fulfilment of the purposes of incorporation, the word "alter" must be reasonably construed, and the power of the state held restricted to legislation fairly amendatory of the original constitution.¹ The state may at any time repeal the constitution of the corporation, but the state cannot, under the reserved power to alter, substitute entirely different purposes of incorporation, and compel the fulfilment of them. It could not, for instance, so alter the charter of a railroad corporation as to force it to run a line of steamboats, for it is plain that any such change is not within the scope of the duty assumed by the corporation, and it is questionable whether a court would entertain a proceeding to forfeit the franchises of the corporation for not fulfilling such unreasonably imposed and unlooked for duties. Neither may the state, under the power to alter and amend, deprive the corporation of its property; for instance, it cannot, by compelling a plank road company to remove a toll-gate, practically deprive it of several miles of the most valuable portion of its road.² As Justice Swayne said, giving the opinion of the court in *Shields v. Ohio*:³ "The power of altera-

tion, may be enforced for the public benefit, as upon the contract between the corporation and the state."

¹ The right of the legislature under reservation of power to amend, alter, or repeal the charter of a railroad company, includes authority to withdraw powers already granted, and to confer new powers and require their exercise, and is independent of the assent of the corporation. A statute requiring certain railroad corporations to unite in a passenger station in Worcester, and to extend their tracks in that city to such station, and after such extension to discontinue certain portions of their present locations, is a valid exercise of the power to alter and amend. *Mayor, etc. of Worcester v. Norwich and Worcester R. R. Co.*, 109 Mass. 103. See *English v. New Haven and Northampton Co.*, 32 Conn. 240; *Robinson*

v. Gardiner, 18 Gratt. (Va.) 509; *Sprigg v. Western Telegraph Co.*, 46 Md. 67; *West End, etc. R. R. Co. v. Atlanta, etc. R. R. Co.*, 49 Ga. 151; compare *Yeaton v. Bank of the Old Dominion*, 21 Gratt. (Va.) 593. Under such reservation rates of toll may be limited. *Parker v. Metropolitan R. R. Co.*, 109 Mass. 506; see *Fitchburg R. R. Co. v. Grand Junction R. R. and Depot Co.*, 4 Allen, 198; *American Coal Co. v. Consolidation Coal Co.*, 46 Md. 15; see §§ 476 *a*, 476 *b*.

² *Detroit v. Detroit, etc. Plank Road Co.*, 43 Mich. 140. In *Orr v. Bracken County, etc.* 81 Ky. 593, it was held that the legislature, under its power to alter and amend, could not change the control of corporate affairs by giving to each shareholder as many votes as he held shares. *Sed quære.*

³ 95 U. S. 319, 324.

tion and amendment is not without limit. The alterations must be reasonable, they must be made in good faith, and be consistent with the scope and object of the act of incorporation. Sheer oppression and wrong cannot be inflicted under the guise of amendment or alteration. Beyond the sphere of the reserved powers, the vested rights of property of corporations in such cases are surrounded by the same sanctions, and are as inviolable as in other cases."¹

§ 503. When the legislature reserves the right to annul the charter of a corporation, if the corporation misuses its powers or fails to begin active operations within a certain time, it has been held that the legislature may exercise its right without the interposition of a judicial tribunal.² Undoubtedly, if the legislature reserves the unconditional right to alter and repeal, it may exercise that right in its discretion; but when that right is conditioned on an abuse of corporate powers, it would seem to be little more than the ordinary right of the state to proceed by *quo warranto*. Accordingly, that the corporation should have an opportunity to be heard in its defence, and that some judicial tribunal should pass upon the question whether there has been

When a judicial proceeding prerequisite to the repeal.

¹ See also *Commissioners v. Holyoke Water Power Co.*, 104 Mass. 446, practically overruling *Commonwealth v. Essex County*, 13 Gray, 239; *Holyoke Co. v. Lyman*, 15 Wall. 500 (affirming *Commrs. v. Holyoke Water Power Co.*, *supra*); *Zabriskie v. Hackensack, etc. R. R. Co.*, 18 N. J. Eq. 178; see also §§ 533-535.

² *Miners' Bank v. United States*, 1 Greene (Iowa), 553. The power to repeal for abuse of corporate privileges is a different right from that of demanding a judicial sentence of forfeiture. After an abuse has occurred the legislature is invested with full power to repeal the charter, and the corporations hold their franchises from the state merely as tenants at will, in the same manner as if there had been

an unconditional reservation of the right to repeal. Judicial proceedings taken against the corporation by the attorney-general, under which the corporation is compelled to remedy certain of its abuses, do not deprive the state of its power of repeal for the abuse. A repealing statute will be presumed to have been passed on the existence of the fact on which its validity depends. *Erie and N. E. R. R. Co. v. Casey*, 26 Pa. St. 287 (decided by a bare majority). But the legislature is not the final judge as to whether the *casus judicis*, upon which is based its authority to repeal, has accrued: *Commonwealth v. Pittsburgh and C. R. R. Co.*, 58 Pa. St. 26; *Erie and W. E. R. R. Co. v. Casey*, 26 Pa. St. 287.

an abuse of corporate powers, or a failure to exercise them, would seem prerequisite,¹ for the legislature is not the proper body to construe a contract between itself and a group of citizens.²

§ 504. The repeal of a general enabling act does not affect the capacities of corporations already formed under it,³ unless the legislative intention to dissolve existing corporations is clearly expressed in the repealing statute.⁴ The legal effect of the repeal by the legislature of a charter of a corporation is clearly stated in the following words of Justice Miller, giving the opinion of the court in *Greenwood v. Freight Company*:⁵ "Whatever force the law may give to transactions into which the corporation entered, and which were authorized by its charter when in force, [after the repeal of its charter] it can originate no new transactions dependent on the power conferred by the charter. If the corporation be a bank, with power to lend money, and to issue circulating notes, it can make no new loan nor issue any new notes designed to circulate as money. If the essence of the grant of the charter be to operate a railroad, and to use the streets of a city for that purpose, it can no longer so use the streets of the city, and no longer exercise the franchise of running a railroad in the city. In short, whatever power is dependent solely upon the grant of the charter, and which could not be exercised by unincorporated private persons under the general laws of the state, is abrogated by repeal of the law, which granted these special rights. Personal and real property acquired by the corporation during its lawful existence, rights of contract, or choses in action so acquired, and which do not in their nature depend upon the general powers conferred by the charter, are not destroyed by such repeal; and the courts may, if the legislature

¹ *Mayor of Baltimore v. Pittsburgh and Cornellville R. R. Co.*, 1 Abb. U. S. 9; accord, *Flint, etc. Plankroad Co. v. Woodhull*, 25 Mich. 99; compare *Grand Gulf R. R. Co. v. State of Mississippi*, 18 Miss. 428, and § 458.

² *Commonwealth v. Proprietors of New Bedford Bridge*, 2 Gray, 339; compare *City of London v. Wood*, 12 Mod. 669, 687.

³ *United Hebrew Association v. Benshimol*, 130 Mass. 325; *Donworth v. Coolbaugh*, 5 Iowa, 300.

⁴ *Freehold Mutual Loan Association v. Brown*, 29 N. J. Eq. 121; *Wilson v. Tesson*, 12 Ind. 285.

⁵ 105 U. S. 13, 18. See also *People v. O'Brien*, 45 Hun (N. Y.), 519.

does not provide some special remedy, enforce such rights by the means within their power. The rights of the shareholders of such a corporation to their interest in its property are not annihilated by such a repeal, and there must remain in the courts the power to protect those rights."

§ 505. Having considered the relations between the state and the corporation, a few words may be said as to the relations more particularly subsisting between the state and (a) the shareholders, (b) the directors and other officers and agents of the corporation, and (c) the creditors of the corporation.

Relations between the state and the individuals interested in the corporate enterprise.

The contract with the state, when there is one, is between the state and the original incorporators, who incorporate themselves by accepting the constitution of the corporation. Their incorporation enables them, within the scope of the corporate powers, to act as a body corporate, and places their rights and interests in the hands of a majority of their own number and of the corporate agents. Accordingly, it is the province of the body corporate or corporate management, to protect the interests of all the shareholders against the consequences of unconstitutional action on the part of the state. Nevertheless, when the corporation fails to act in defence of corporate interests, a shareholder may.¹ As the corporation, however, cannot sue the state directly to compel it to repeal an unconstitutional law, nor to obtain damages from the state for the effects of such a law,² it is usually in the legal relations between the shareholders and other persons in any way interested in the corporate enterprise, that the consequences of unconstitutional legislation show themselves.³ As, for instance, questions arising under a law imposing increased personal liability upon share-

¹ Where the legislature of a state has repealed the charter of a street railroad company, and transferred its franchises and track to another, and the corporation refuses to seek a remedy in the courts, a stockholder of the company will have a standing in a court of equity to obtain an injunction on the ground that the repealing statute impairs the obligation of a con-

tract. *Greenwood v. Freight Company*, 105 U. S. 13. See §§ 138 *et seq.*

² See § 462.

³ A statute to the effect that all dividends not claimed within five years shall be paid to a university, impairs the obligation of a contract. *University v. North Carolina R. R. Co.*, 76 N. C. 103.

holders would come up between shareholders and creditors endeavoring to enforce this improperly increased liability of shareholders.¹ It would seem that questions directly between the state and shareholders could arise only when a shareholder is defending his interests against the action of government agents seeking to carry into effect the provisions of some unconstitutional law.² The usual object and principal effect of laws made by the state are not to create any relations between the state and its citizens, but to affect relations among its citizens; to enable them to acquire rights and incur liabilities in a manner different from that in which they could have, before the passage of the law.³

§ 506. Likewise, very seldom would questions arise directly between the state and directors of a corporation. The state may compel directors to perform their duties in so far as a non-performance of them in any way prejudices the public interests;⁴ and directors could resist action by the agents of the state of an improper nature, and in so doing rest their defence on the nullity of the authority relied on by such agents. The state may create penalties for breaches of trust or failure to fulfil their duties on the part of directors; and here again if the penalties were enforceable at the suit of those persons for whose protection they were created, the questions as to them would arise between those persons and the directors. Penalties, moreover, cannot be constitutionally imposed for past transactions.⁵

¹ See §§ 500, 501.

² *E. g.*, to restrain the collection of an illegal tax. See Delaware Railroad Tax, 18 Wall. 206.

When a stockholder sues to restrain the collection of an illegal tax (when the corporation refuses), a demurrer lies to his complaint unless the corporation is made a party. *Davenport v. Dows*, 18 Wall. 626.

³ But a question might arise in an entirely different way between the state or the United States, and a corporation, and its shareholders. Thus a shareholder was indebted to his bank,

and also to the United States. By its charter the bank had a lien on its stock for the payment of debts due it by shareholders, and insisted on this lien against the claim for priority of payment asserted on the part of the United States. The bank was sustained. *Brent v. Bank of Washington*, 10 Pet. 596.

⁴ *E. g.*, by making given acts or omissions criminal.

⁵ Even when the state reserves the right to alter and repeal. *White v. How*, 3 McLean, 111.

§ 507. Finally, in regard to creditors of the corporation, questions as to the constitutionality of legislation in respect of the corporate enterprise, would usually come up between creditors and the corporation;¹ or between creditors and shareholders or directors;² or among creditors.³ However, when a state, that has provided in the charter of a bank that its bills shall be receivable for state taxes, attempts to repeal this provision, the question of the constitutionality of the repeal would arise directly between the state officers and the billholders. Such a provision is held to constitute a contract between the state and the holders of the bank bills in circulation, and a contract which the state cannot affect by subsequent legislation.⁴

¹ *E. g.*, where the legislature of a state authorized commissioners to borrow money to be used in making a canal, and, for the redemption of the loan, pledged the canal, with its tolls and lands, the lien of a lender under the act cannot be divested or postponed by subsequent legislation. Trustees of the Wabash and Erie Canal Co. v. Beers, 2 Black, 448; compare Curran v. Arkansas, 15 How. 304; § 501.

The legislature may constitutionally enact a law providing that, unless a creditor of an embarrassed corporation expresses his dissent within a specified time from measures deemed essential to the common welfare of the corporation and its creditors, he shall be held to have assented to them. Union Canal Co. v. Gilfillin, 93 Pa. St. 95; S. C., *aff'd*, 109 U. S. 401.

² See §§ 500, 501. When the state is a shareholder, questions may arise between the creditors of the corporation and the state as shareholder in the corporation or contributor of its capital. See Curran v. Arkansas, 15 How. 304.

³ See Barings v. Dabney, 19 Wall. 1. So questions as to the competency of a court to authorize a receiver to

issue certificates making them liens prior to the lien of a mortgage, would arise among creditors. See, *e. g.*, Fosdick v. Schall, 99 U. S. 235; Wallace v. Loomis, 97 U. S. 146. See §§ 821 *et seq.*

⁴ Woodruff v. Trapnall, 10 How. 190. In this case the state was the sole shareholder. See Paup v. Drew, 10 How. 218; Furman v. Nichol, 8 Wall. 44; Wagner v. Stall, 2 S. C. 538. Such bank bills are not "bills of credit" within the meaning of the Constitution. Darrington v. Bank of Alabama, 13 How. 12.

In 1836 Maryland passed a law directing a subscription of \$3,000,000 to the capital stock of the Baltimore and Ohio R. R. Co., with the following proviso: "That if the said company shall not locate the said road in the manner provided for in this act, they shall forfeit \$1,000,000 to the state of Maryland for the use of Washington County." In 1841 the state repealed so much of the prior act as made it the duty of the railroad company to locate its road as prescribed, and released the penalty. *Held*, that the above proviso was a penalty, and measure of state policy, which the state might change; and that neither the county

Similarly, in *Curran v. Arkansas*¹ litigation arose directly between the state and the billholders of a bank of which the state incorporating the bank was the sole shareholder.² The state had withdrawn the funds of the bank by means of statutes at variance with the provisions of its charter; and these statutes, with the action of the state officers in accordance with them, the Federal Supreme Court held to impair the obligation of the contract between the billholders and the bank, as well as that of the contract between the state and the billholders. Giving the opinion of the court, Justice Curtis said: "It is true that as the state was the sole stockholder in this bank, the charter cannot be deemed to be such a contract between the state and the corporation as is protected by the Constitution of the United States. But it is a very different question whether that charter does not contain provisions, which, when acted upon by the state and by third persons, constitute in law a binding contract between them. . . . Now the charter of this bank provides that it shall have a capital stock of one million dollars to be raised by the sale of the bonds of the state, and also that certain other funds, that are specifically described, shall be deposited therein by the state, and constitute a part of the capital stock of the bank. . . . The bank received this money from the state as the fund to meet its engagements with third persons which the state, by the charter, expressly authorized it to make for the profit of the state. Having thus set apart this fund in the hands of the bank, and invited³ the public to give credit to it, under an assurance that it had been placed there for the purpose of paying the liabilities of the bank, whenever such credit was given, a contract between the state and the creditor not to withdraw that fund to his injury at once arose."³

nor any of its citizens acquired any separate or private interest in it. *Maryland v. Baltimore and Ohio R. Co.*, 3 How. 534; compare *Chamberlain v. St. Paul, etc. R. R. Co.*, 92 U. S. 299.

¹ 15 How. 304.

² A statute authorizing suits against the state existed.

³ 15 How. 313. *Catron, Daniel, and Nelson, JJ.*, dissented. Compare *Forstall v. Consolidated Association*, 34 La. Ann. 770. When a state is a stockholder in a private corporation, it is bound by the provisions of the charter as an individual. *Marshall v. Western N. C. R. R. Co.*, 92 N. C. 322.

CHAPTER IX.

LEGAL RELATIONS BETWEEN THE CORPORATION AND ITS SHAREHOLDERS.

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| <p>Legal relations discussed in this chapter, § 508.</p> <p>Legal relations between shareholders and the corporation, how occasioned, § 509.</p> <p>Contracts to take shares, § 510.</p> <p>Issue of certificate not essential, § 511.</p> <p>Legal relations; general character, § 512.</p> <p>Implied promise of subscriber to pay for the shares, §§ 513, 514.</p> <p>Consideration, § 515.</p> <p>Prescribed forms. Failure to pay preliminary deposit, § 516.</p> <p>Conditions. Levy of assessment, § 517.</p> <p>Subscription of total amount named in articles, § 518.</p> <p>Waiver of condition. Estoppel, § 519.</p> <p>Provisions construed not to be conditions, § 520.</p> <p>Verbal conditions and secret agreements void, § 521.</p> <p>"Non-assessable," § 522.</p> <p>Subscriptions obtained by fraud voidable, provided subscriber acts with despatch, § 523.</p> <p>English and American views, § 524.</p> <p>Rationale, §§ 525, 526.</p> <p>Effect of error, § 527.</p> <p>Subscriptions, how affected by subsequent unauthorized or improper action on the part of the corporation, §§ 528, 529.</p> <p>Change in the corporate enterprise by legislative action, §§ 530-532.</p> | <p>Power reserved to the state to alter and repeal, §§ 533-535.</p> <p>Effect of consolidation, § 536.</p> <p>When subscriber cannot plead <i>null tiel corporation</i>, § 537.</p> <p>When he may, §§ 538, 539.</p> <p>Shareholders may plead that officers making calls not legally elected, § 540.</p> <p>Subscribers to shares irregularly or illegally issued, § 541.</p> <p>Insolvency of corporation no defence. Capacities of receiver, § 542.</p> <p>Directors cannot delegate authority to make calls. When calls unnecessary, §§ 543, 544.</p> <p>Corporation may receive property in payment for its shares, § 545.</p> <p>Forfeiture of shares for non-payment of calls, §§ 546, 547.</p> <p>Collusive forfeitures, § 548.</p> <p>Release of subscriber void, §§ 549-551.</p> <p>Purchase of shares by the corporation, § 552.</p> <p>Right of the corporation to control the corporate enterprise, § 553.</p> <p>Courts will not interfere at the suit of shareholders, § 553.</p> <p>Unless to restrain acts which are <i>ultra vires</i>, or constitute a breach of trust, §§ 555, 556.</p> <p>When shareholders may enjoin the acceptance of an amendment, § 557.</p> <p>Corporate affairs must be managed in the interests of the shareholders as such, §§ 558, 559.</p> |
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- Right of shareholders to sue the corporation and its officers for conspiracy, § 560.
- Like outsiders, a shareholder may sue the corporation, § 561.
- Shareholders have no unconditional right to a division of profits, § 562.
- But courts will sometimes interfere, especially in favor of preferred shareholders, § 563.
- Preferred dividends cumulative, § 564.
- Dividends can be paid only out of profit, § 565.
- Recovery of dividends illegally paid, §§ 566, 567.
- Rights of shareholders after a dividend has been declared, § 568.
- Right to subscribe to additional shares on an increase of the capital stock, § 569.
- Rights on a decrease of stock, § 570.
- Power to issue preferred shares, §§ 571, 572.
- Meetings of the corporation. Notice, §§ 573, 574.
- Who may call meetings, § 575.
- Business irregularly transacted, § 576.
- Voting. Election of officers, § 577.
- Transfer books evidence of right to vote, § 578.
- Voting by proxy, § 579.
- Each shareholder has as many votes as shares. Combinations of shareholders, § 580.
- A court of law the tribunal to deter-
- mine the validity of corporate elections. Injunctions, § 581.
- Power to make by-laws, §§ 582-584.
- Right to inspect corporate books, § 585.
- Transfer of shares. Effect. When corporation is insolvent, § 586.
- Liability of transferee, §§ 587, 588.
- Irregular transfers, §§ 589, 590.
- Liability of corporation for excessive issues, § 591.
- Liability of corporation in registering transfers, § 592.
- Registry of transfers on forged orders, § 593.
- In violation of by-laws, § 594.
- In disregard of rights of which the corporation has no notice, § 595.
- Interpleader, § 596.
- Registry of transfers by mistake, § 597.
- Estoppel of corporation by its certificate, § 598.
- Right of purchaser to a transfer; to damages, § 599.
- Lien of a corporation on its shares, §§ 600-602.
- Effect of lien, § 603.
- Its scope, §§ 604, 605.
- Waiver of lien, §§ 606, 607.
- Right of shareholders in respect of winding up, §§ 608, 609.
- Power of majority to dissolve; of minority, § 610.
- Jurisdiction of equity, § 611.

§ 508. It is the purpose of the present chapter to treat of the legal relations subsisting between individual shareholders, or a minority of shareholders, and the corporation or body corporate, acting as such and exercising directly or through its constituted agencies the corporate powers in the management of the corporate enterprise. The body corporate, acting through whatever agency constitutes the corporate management, is the representative of the rights of all persons interested in the corporate enterprise.

Legal relations discussed in this chapter.

Therefore, ordinarily, to an action brought by the corporation against a shareholder, for instance to enforce his subscription, no defence can be pleaded that would impair the rights of any persons respecting the corporate funds. With a view, however, to a proper arrangement of topics, discussion of legal relations subsisting directly and apparently among shareholders, and between shareholders and corporate officers and creditors will be reserved for future chapters.

§ 509. Legal relations between shareholders¹ and the body corporate are occasioned in the first instance by purchasing, subscribing for, or contracting to take shares of stock. The shareholder is thus brought within the operation of rules of law entering into the constitution of the corporation, which thereupon manifest themselves in legal relations not only between the shareholder and the body corporate, but also between the shareholder and all other persons in any way interested in the corporate enterprise. But in this chapter, as before remarked, we are concerned only with the relations of these persons as represented by the corporation.

Legal relations between shareholders and the corporation : how occasioned.

§ 510. The forms of contracts to take shares in the stock of a corporation may differ,² but the legal relations occasioned by them are similar.³ A contract of this kind is in the main a contract to subscribe funds for

Contracts to take shares.

¹ "The type . . . of a member or shareholder of a company is a person who has agreed to become a member, and with regard to whom all conditions precedent to the acquisition of the rights of a member have been duly observed. Where all these circumstances are combined, there is membership in its fullest and most accurate sense." 1 Lindley on Part. (Am. ed.), 127.

² A stock certificate, although containing an agreement to pay interest to the holder until the happening of a certain event, may still constitute him a shareholder; and the agreement to pay interest is a contract between the holder and the corporation, which can-

not be varied by the vote of a majority of shareholders to pay such interest in bonds. *McLaughlin v. Detroit, etc. R. R. Co.*, 8 Mich. 100. See also *Richardson v. Vermont and Mass. R. R. Co.*, 44 Vt. 613, in which case the interest was payable out of surplus earnings.

³ Mutual insurance companies, in which the insured becomes a member by the payment of the cash premium, are anomalous. The theory of such companies is that the premiums paid by the members for the insurance of their respective properties, constitute a common fund devoted to the payment of any losses that may occur. *Union Ins. Co. v. Hoge*, 21 How. 35.

the accomplishment of a certain purpose, the subscriber to surrender his rights as owner over the funds subscribed, but to retain some of his rights in such funds (as *e. g.*, to have them applied to no other purposes than the objects of incorporation¹) and acquiring through his contract certain other rights (as *e. g.*, the right to act as a member of a corporation), which otherwise he would not have had.

§ 511. To constitute a person a shareholder, it is not necessary that a certificate of stock should have been issued to him;² though it seems a verbal promise to take and pay for shares will not be binding,³ unless a stock certificate has been tendered and accepted.⁴ Where a subscriber acknowledges the receipt of shares which he agrees to pay for in instalments, one of which he actually pays, he will be liable on his subscription, although no certificate of stock has ever been issued to him;⁵ and, unless a subscription is

Issue of
certificate
not essen-
tial.

¹ "When any person takes stock in a railroad company, he has entered into a contract with the company that his interest shall be subject to the direction and control of the proper authorities of the corporation to accomplish the object for which the company was organized. He does not agree that the improvement to which he subscribes should be changed in its purposes and character, at the will and pleasure of a majority of the stockholders, so that new responsibilities, and it may be new hazards, are added to the original undertaking." *Clearwater v. Meredith*, 1 Wall. 25, 40.

² *Chaffin v. Cummings*, 37 Me. 76; *Beckett v. Houston*, 32 Ind. 393; *Slipher v. Earhart*, 83 Ind. 173; *Haynes v. Brown*, 36 N. H. 545, 563; *Schaeffer v. Missouri Home Ins. Co.*, 46 Mo. 248; *Chester Glass Co. v. Dewey*, 16 Mass. 94; *Burr v. Wilcox*, 22 N. Y. 551; *Chesley v. Pierce*, 32 N. H. 388, 402; *Mitchell v. Beckman*, 64 Cal. 117; see *Thorp v. Woodhull*, 1 Sandf. Ch. (N. Y.) 411; and com-

pare *Courtright v. Deeds*, 37 Iowa, 503. But compare *Busey v. Hooper*, 35 Md. 15; *Mount Sterling Coal Road Co. v. Little*, 14 Bush (Ky.), 429.

³ *Fanning v. Insurance Co.*, 37 Ohio St. 339; *Vreeland v. New Jersey Stone Co.*, 29 N. J. Eq. 188. (In these cases the charters indicated that writing was essential.) *Pittsburgh and Steubenville R. R. Co. v. Gazzam*, 32 Pa. St. 340. A transfer cannot be established by parol. *Pittsburgh and Connellsville R. R. Co. v. Clarke*, 29 Pa. St. 146. But in the late case of *Colfax Hotel Co. v. Lyon*, 69 Iowa, 683, a verbal subscription contract was held valid, the charter of the corporation and the general statutes of the state containing no provisions regulating the form of such contracts.

⁴ *Upton v. Tribilcock*, 91 U. S. 45.

⁵ *Hawley v. Upton*, 102 U. S. 314. In this case the subscriber had not demanded a certificate. Compare *Wemple v. St. Louis, etc. R. R. Co.*, 120 Ill. 196.

expressly made payable on call no notice to the subscriber is necessary before bringing suit.¹ "A certificate of the shares of stock of a railway company is merely a solemn affirmation under the seal of the company that a certain amount of shares of stock stands in the name of the individual mentioned in the certificate."²

§ 512. Legal relations occasioned by a contract to take shares, just as legal relations occasioned by any other contract, are the manifestations of the rules of law within the operation of which the parties by their contract have brought themselves. If the contract to take shares is binding, that is, if the desired legal relations are occasioned, the rules of law of which the legal relations so occasioned are the manifestation will be those composing the constitution of the corporation; or, speaking more definitely, will be those contained in the charter of the corporation, or in the general enabling statute and articles of association filed in accordance therewith; supplemented by the more general rules of corporation law.³ And a person subscribing for shares is affected with a notice of the obligations which he incurs.⁴

Legal relations; general character.

§ 513. It is the settled law of the United States Supreme Court, and of most of the states, that a subscription for shares implies the promise of the subscriber to pay for them.⁵ And this implied promise arises, although a power to forfeit or sell the shares for non-

Implied promise of subscriber to pay for the shares.

¹ *Lake Ontario, etc. R. R. Co. v. Naason*, 16 N. Y. 451; *Grubb v. Mahoning Nav. Co.*, 14 Pa. St. 302; *Wilson v. Wills Valley R. R. Co.*, 33 Ga. 466. Personal demand before suit for calls may be made necessary by statute. *Scarlett v. Academy of Music*, 43 Md. 203; compare *Sheffield R'y Co. v. Woodcock*, 7 M. & W. 574; *Newry and Enniskillen R'y Co. v. Edmunds*, 2 Exch. 118.

² *Lord Cairns in Shropshire Union R'ys, etc. Co. v. Queen, L. R.* 7 H. L. Cas. 496, 509.

³ See *Hoagland v. Cincinnati and Ft. W. R. R. Co.*, 18 Ind. 452, 454.

⁴ *McKim v. Glenn*, 66 Md. 479;

Chesapeake and Ohio Canal Co. v. Dulany, 4 Cranch, Cir. Ct. 85.

⁵ *Upton v. Tribilcock*, 91 U. S. 45; *Webster v. Upton*, ib. 65; *Lake Ontario, etc. R. R. Co. v. Mason*, 16 N. Y. 451; *Rensselaer, etc. Plankroad Co. v. Barton*, ib. 457, note; *Miller v. Wild Cat Gravel Road Co.*, 52 Ind. 51; *Sagory v. Dubois*, 3 Sandf. Ch. (N. Y.) 466; *Dayton v. Borst*, 31 N. Y. 435; *Fry's Ex'r v. Lexington, etc. R. R. Co.*, 2 Metc. (Ky.) 314; *Beene v. Cahawba, etc. R. R. Co.*, 3 Ala. 660; *Gill's Adm'r v. Kentucky, etc. Mining Co.*, 7 Bush (Ky.), 635; *Chase v. Railroad Co.*, 5 Lea (Tenn.), 415; *Waukon, etc. R. R. Co. v. Dwyer*, 49

payment may be expressly given to the corporation.¹ The courts of Massachusetts, Maine, and, possibly, New Hampshire, follow a contrary doctrine, holding that a subscription for shares in a corporation subjects the subscriber only to the liabilities imposed by the statute under which the corporation was organized; and when a corporation is authorized by statute to assess the shares, and sell them for non-payment of assessments, and a subscriber has not expressly promised to pay assessments no promise can be implied which will enable the corporation to maintain an action against him personally, even though the sale of the shares under the statute fails to bring enough to pay the assessment.²

§ 514. The following statement of the law in New Hampshire is at least lucid, whatever objection may be taken to it: "Where a party makes an express promise to pay the assessments, he is answerable to the corporation upon such promise for all legal assessments, and may be compelled to its performance by an action at law, before resorting to a sale of the shares. It is a personal undertaking beyond the terms of the charter. Where, on the other hand, he only agrees to take a specified number of shares, without promising expressly to pay assessments, then resort must first be had to a sale of the shares to

Iowa, 121; *Nulton v. Clayton*, 54 Iowa, 425; *Mansfield, etc. R. R. Co. v. Brown*, 26 O. St. 223. See *Small v. Herkimer M'f'g Co.*, 2 N. Y. 330. Compare *New Hampshire Cent. R. R. Co. v. Johnson*, 30 N. H. 390; *Mount Sterling Coal Co. v. Little*, 14 Bush (Ky.), 429; *Russell v. Bristol*, 49 Conn. 251.

If a person makes a valid contract on sufficient consideration with a corporation to take stock in it and refuses to comply without fault on the part of the corporation, it may recover such damages for the breach as it has sustained. *Quick v. Lemon*, 105 Ill. 578.

¹ *Dexter, etc. Plankroad Co. v. Millerd*, 3 Mich. 91; *Hughes v. Antietam M'f'g Co.*, 34 Md. 316. Con-

tra, *Odd Fellows' Hall Co. v. Glazier*, 5 Harr. (Del.) 172. See § 546.

² *Mechanics' Foundry, etc. Co. v. Hall*, 121 Mass. 272. See also *Kennebec, etc. R. R. Co. v. Kendall*, 31 Me. 470; *Belfast, etc. R. R. Co. v. Moore*, 60 Me. 561; *Penobscot, etc. R. R. Co. v. Dunn*, 39 Me. 587. An amendment to a charter cannot operate to make a subscriber personally liable on his subscription when he was not so liable before. *Belfast, etc. R. R. Co. v. Moon*, 60 Me. 561. But by charter-provisions stocks may be liable to further assessments by the corporation after the full par value has been paid. *Price's Appeal*, 106 Pa. St. 421. Compare *Dewey v. St. Albans Trust Co.*, 57 Vt. 332.

pay the assessments before an action at law can be maintained. His agreement simply to take the shares is an agreement upon the faith of the charter, and by it alone is he to be governed, so far as his shares are to be affected. He takes them upon the conditions and law of the charter. They exist only by virtue of the charter, and are to be governed by the provisions therein contained."¹

§ 515. In the absence of express provisions in the charter or enabling act regulating subscription contracts, whether an implied or express promise to pay for ^{Consideration.} shares may be enforced by the corporation, is to be determined in accordance with the rules of the law of contracts.² In the first place, and principally, was there a consideration?³ When no consideration is expressed, a sufficient one to uphold the contract ordinarily exists in the implied counter-promise of the corporation, in accepting the subscription, to admit the subscriber to all the rights of a shareholder.⁴ This consideration, however, does not exist unless the agreement to subscribe is

¹ *New Hampshire Central R. R. Co. v. Johnson*, 30 N. H. 390, 403.

² *E. g.* To an action on a subscription contract, the infancy of the subscriber may be pleaded. *Newry and Enniskillen R'y Co. v. Combe*, 5 Eng. R'y Cas. 633; *Dublin, etc. R'y Co. v. Black*, 7 Eng. R'y Cas. 434. Compare *Cork, etc. R'y Co. v. Cazenove*, 10 Q. B. 935. Writing one's name in the private memorandum book of a person soliciting subscriptions, does not give that person authority to sign a stock-subscription. *McClelland v. Whiteley*, 15 Fed. Rep. 322.

³ An agreement by a person to act as director and to give the business of his firm to a bank, is a sufficient consideration to support a contract on the part of the bank to give him the requisite number of shares to qualify as a director. *Rich v. State Nat. B'k*, 7 Neb. 201. There is no question that there is a consideration for notes given

to a corporation by a subscriber to secure payments on his shares. *Chetlain v. Republic Life Ins. Co.*, 86 Ill. 220.

⁴ *Kennebec and Portland R. R. Co. v. Jarvis*, 34 Me. 360; *Stokes v. Lebanon, etc. Turnpike Co.*, 6 Humph. (Tenn.) 241; *Thigpen v. Miss. Cent. R. R. Co.*, 32 Miss. 347; *East Tennessee, etc. R. R. Co. v. Gammon*, 5 Sneed (Tenn.), 567. See *Starratt v. Rockland Fire Ins. Co.*, 65 Me. 374. Compare *University of Des Moines v. Livingston*, 57 Iowa, 307. When commissioners are appointed to receive subscriptions under a statute which does not provide for the event of an excess of subscriptions over the authorized capital, and subscriptions in excess are made, every subscriber acquires the right to some stock. *Meads v. Walker, Hopk. Ch. (N. Y.)* 587. See *Clarke v. Brooklyn Bank*, 1 Edw Ch. (N. Y.) 361.

made either with the corporation or its agent,¹ or is subsequently accepted by the corporation.² If at the time of subscribing, the subscribers make a part payment or deposit on account of their subscriptions, the making of these deposits by the different subscribers and the receiving of them by the corporation, which latter must be held by so doing impliedly to agree to apply them to the purposes of incorporation, will constitute a sufficient consideration to prevent any subscriber from withdrawing his deposit, as well as a sufficient consideration to enable the corporation to compel the subscribers to complete the full amount of their subscriptions.³

§ 516. When in the constitution of a corporation, any particular form for a contract of subscription is prescribed, it may be inferred that that form, if followed, will constitute a binding contract.⁴ But the fact that the form prescribed was not followed, will not necessarily invalidate a subscription;⁵ nor will a subscriber be allowed to take advantage of his own non-performance of conditions precedent prescribed by the constitution, in order to invalidate his subscription agreement, at least if any one who has acted on the faith of such agreement would be injured by its non-fulfilment. Thus, where the constitution of the corporation requires a preliminary deposit to be paid by the sub-

¹ *Lake Ontario R. R. Co. v. Curtiss*, 80 N. Y. 219; *Essex Turnpike Co. v. Collins*, 8 Mass. 292; *Lowe v. E. and K. R. R. Co.*, 1 Head (Tenn.), 659; *Parker v. Northern Centr. Mich. R. R. Co.*, 33 Mich. 23; *Wallace v. Townsend*, 43 O. St. 537. Compare *Workman v. Campbell*, 46 Mo. 305.

² *Walker v. Mobile, etc. R. R. Co.*, 34 Miss. 245; *Northern Central Mich. R. R. Co. v. Eslow*, 40 Mich. 222; *Stevens v. Corbitt*, 33 Mich. 458; *Michigan, Midland, etc. R. R. Co. v. Bacon*, ib. 466. See *Mobile and Ohio R. R. Co. v. Yandal*, 5 Sneed (Tenn.), 294. An offer to subscribe to stock of a railroad company in case of a specified extension of its road is revocable

until delivered to the company; and the death of the offerer is a revocation. *Wallace v. Townsend*, 43 O. St. 537. See § 108.

³ See § 98, and generally §§ 91-98, for a discussion of the consideration necessary to uphold an agreement to subscribe.

⁴ *Parker v. Northern Central R. R. Co.*, 33 Mich. 23. See § 91.

⁵ Still the omission of some prescribed formality may render a subscription incomplete and therefore invalid. See *Dutchess, etc. R. R. Co. v. Mabbett*, 58 N. Y. 397; *Carlisle v. Saginaw Valley R. R. Co.*, 27 Mich. 315; *Shurtz v. Schoolcraft, etc. R. R. Co.*, 9 Mich. 269.

scriber, and the subscriber fails to pay it, he may not plead his own omission in answer to a suit for calls.¹ This seems entirely correct on principle, though there are decisions to the contrary.²

§ 517. If the contract of subscription is to be held binding, then must be considered whether it is so absolutely or conditionally.³ It will be binding absolutely when conditions neither exist in the contract itself nor can be imported into it from the constitution of the corporation. Otherwise, it will be binding conditionally until the performance of the conditions, provided they are performed within a reasonable time,⁴ whereupon it will become binding absolutely.⁵ Accordingly, where, by the terms of the

Conditions.
Levy of
assessment.

¹ *Lake Ontario, etc. R. R. Co. v. Mason*, 16 N. Y. 451; *Rensselaer, etc. Plank Road Co. v. Barton*, ib. 457, note; *Illinois River R. R. Co. v. Zimmer*, 20 Ill. 654; *Ryder v. Alton, etc. R. R. Co.*, 13 Ill. 516; *Haywood, etc. Plank Road Co. v. Bryan*, 6 Jones (N. C.) Law, 82; *Home Stock Ins. Co. v. Sherwood*, 72 Mo. 461; *Sedalia W. and S. Ry. Co. v. Abell*, 17 Mo. App. 645; *Thorp v. Woodhull*, 1 Sandf. Ch. (N. Y.) 411; *Vicksburg, etc. R. R. Co. v. McKean*, 12 La. Ann. 638; *Mitchell v. Rome R. R. Co.*, 17 Ga. 574; *Wight v. Shelby R. R. Co.*, 16 B. Mon. (Ky.) 4; *Piscataqua Ferry Co. v. Jones*, 39 N. H. 491; *Pittsburgh W. and R. R. Co. v. Applegate*, 21 W. Va. 172.

² *Wood v. Coosa, etc. R. R. Co.*, 32 Ga. 273; *Jenkins v. Union Turnpike Co.*, 1 Caines Cas. in Er. (N. Y.) 86; *Goshen, etc. Turnpike Co. v. Hurtin*, 9 Johns. 217; *Boyd v. Peach Bottom R'y Co.*, 90 Pa. St. 169. See *Excelsior Grain Binder Co. v. Stayner*, 25 Hun. 91; *Fiser v. Miss. and Tenn. R. R. Co.*, 32 Miss. 359. Compare *Garrett v. Dillsburg, etc. R. R. Co.*, 78 Pa. St. 465.

³ Subscribing conditionally to shares

does not make the subscriber a shareholder till the condition is performed. *Evansville, etc. R. R. Co. v. Shearer*, 10 Ind. 244. It is held in Pennsylvania that when one subscribes conditionally to the stock of a railroad company, before the procurement of its charter, the condition is void and the subscription is absolute. *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29; *Caley v. Phila., etc. R. R. Co.*, 80 Pa. St. 263; *Pittsburgh and S. R. R. Co. v. Biggar*, 34 Pa. St. 455. The writer fails to see the correctness of these decisions, which in effect make for the subscriber a contract he never entered into. They did not turn on any question of the condition being verbal or written.

⁴ See *Fountain Ferry T. R. Co. v. Jewell*, 8 B. Mon. (Ky.) 141. If the corporate enterprise is not started in good faith within the period prescribed by the charter, a subscriber is released. *McCully v. Pittsburgh and Connellsville R. R. Co.*, 32 Pa. St. 25. See also *Ramsgate Victoria Hotel Co. v. Montefiore*, 4 H. & C. 164.

⁵ *Chamberlain v. Painesville, etc. R. R. Co.*, 15 Ohio St. 225; *Ashtabula, etc. R. R. Co. v. Smith*, ib. 328;

subscription, the subscriber agreed to take shares and pay all charges and assessments regularly levied or assessed by the board of directors, it was held that the corporation could not recover until an assessment had been made; and, further, that the terms of the subscription could not be contradicted by parol proof of an understanding that payment should be made without calls.¹ Likewise, if the charter of a corporation does not definitely fix the number of shares of which the capital stock is to be composed, this number must be fixed by the proper authority before a valid assessment can be laid on subscribers.²

§ 518. Again, if the contract to subscribe is conditioned on the subscription of a certain amount, it may not be enforced until that amount is subscribed for;³ and if a certain amount of stock is mentioned in the charter or articles of association, a contract to subscribe is impliedly conditioned on the subscription of that amount,⁴

Subscription of total amount named in articles.

Mansfield, etc. R. R. Co. v. Brown, 26 O. St. 223; *Racine County Bank v. Ayres*, 12 Wis. 512; *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536, 543; *Pittsburgh and Connellsville R. R. Co. v. Stewart*, 41 Pa. St. 54; *Caley v. Phila. and Chester Co. R. R. Co.*, 80 Pa. St. 263.

A corporation suing for the whole subscription may recover what is due unconditionally, though it fail to establish its right to recover the rest. *St. Louis and Cedar Rapids R. R. Co. v. Eakins*, 30 Iowa, 279. But a conditional subscription has been held a mere offer, revocable until the condition is performed. *Garret v. Dillsburg, etc. R. R. Co.*, 78 Pa. St. 465.

¹ *Grosse Isle Hotel Co. v. I'Anson*, 43 N. J. L. 442. But the subscriber cannot dispute the necessity of the assessment. *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286. Right of action on a subscription made subject to call does not accrue till the call is made, and consequently not till then does the statute of

limitations begin to run. *Macon and A. R. R. Co. v. Vason*, 52 Ga. 326. Compare *Braddock v. Philadelphia M. and M. R. R. Co.*, 45 N. J. L. 363.

² *Somerset R. R. Co. v. Clarke*, 61 Me. 379; *Same v. Cushing*, 45 Me. 524; *Worcester and Nashua R. R. Co. v. Hinds*, 8 Cush. 110. Compare *Bucksport, etc. R. R. Co. v. Buck*, 65 Me. 536; *Pike v. Bangor, etc. Shore Line R. R. Co.*, 68 Me. 445.

³ *Philadelphia and West Chester R. R. Co. v. Hickman*, 28 Pa. St. 318; *Chase v. Sycamore, etc. R. R. Co.*, 38 Ill. 215; *Morris Canal, etc. Co. v. Nathan*, 2 Hall (N. Y.), 239; *Belfast and M. L. R. R. Co. v. Cothrell*, 66 Me. 185; *Monadnock R. R. v. Felt*, 52 N. H. 379.

⁴ *Atlantic Cotton Mills v. Abbot*, 9 Cush. 423; *Katama Land Co. v. Jernegan*, 126 Mass. 155; *Read v. Memphis Gayoso Gas Co.*, 9 Heisk. (Tenn.) 545; *Littleton M'fg Co. v. Parker*, 14 N. H. 543; *Contoocook Valley R. R. v. Barker*, 32 N. H. 363; *Peoria*

unless the terms of the subscription contract are plainly inconsistent with the existence of such implied conditions.¹ And the subscriptions, to fulfil this condition, must be valid and made by solvent persons apparently able to pay for the shares subscribed for by them.² It may be added generally, that whatever conditions are imposed on the corporation by the subscription contract must be performed before the contract can be enforced.³ But the rule that, when the capital stock is fixed by the charter, an action does not lie to enforce a subscription until all the stock is taken, does not apply where, from the face of the charter, it is obvious that the whole of the capital stock was not necessary to the organization of the company, and the subscriber knew, or had reason to know, this at the time of subscribing; nor does it apply where a subscriber takes part in

and *R. I. R. R. Co. v. Preston*, 35 Iowa, 115; *Memphis Branch R. R. Co. v. Sullivan*, 57 Ga. 240; *Allman v. Havana, etc. R. R. Co.*, 88 Ill. 521; *Hughes v. Antietam M'fg Co.*, 34 Md. 316; *Elder v. New Zealand Land Improvement Co.*, 30 L. T. N. S. 285; *Hendrix v. Academy of Music*, 73 Ga. 437; *Hale v. Sanborn*, 16 Neb. 1; *Rockland, etc. Steamboat Co. v. Sewall*, 78 Me. 167. See *People's Ferry Co. v. Balch*, 8 Gray, 303; *Pierce v. Jersey Water Works Co.*, L. R. 5 Exch. 209. Compare *M'Dougall v. Jersey Imperial Hotel Co.*, 10 Jur. N. S. 1043; *Warwick R. R. Co. v. Cady*, 11 R. I. 131; *Nutter v. Lexington, etc. R. R. Co.*, 6 Gray, 85. Contra, *Nelson v. Blakey*, 54 Ind. 29. See also § 96.

¹ *Iowa and Minn. R. R. Co. v. Perkins*, 28 Iowa, 281; see *Selma, M., and M. R. R. Co. v. Anderson*, 51 Miss. 829; *Skowhegan and A. R. R. Co. v. Kinsman*, 77 Me. 370; *Sedalia, W., and S. Ry. Co. v. Abell*, 17 Mo. App. 645.

² *Lewey's Island R. R. Co. v. Bolton*, 48 Me. 451; *Phillips v. Covington, etc. Bridge Co.*, 2 Met. (Ky.) 219. See *Holman v. State*, 105 Ind. 569, 571.

³ *Santa Cruz R. R. Co. v. Schwartz*, 53 Cal. 106; *Swartwout v. Mich. Air Line R. R. Co.*, 24 Mich. 389; *Carlisle v. Cahawba, etc. R. R. Co.*, 4 Ala. 70; *Trott v. Sarchett*, 10 O. St. 241; *Thompson v. Oliver*, 18 Iowa, 417; *Burlington and M. R. R. R. Co. v. Boestler*, 15 Iowa, 555. A subscription may be received by a railroad company conditioned on a specified location of its road; and cannot be enforced unless the condition is complied with. *Nashville and N. W. R. R. Co. v. Jones*, 2 Cold. (Tenn.) 574; *Missouri Pac. Ry. Co. v. Tygard*, 84 Mo. 263, and preceding cases.

When on subscribing and paying for shares the subscriber makes a contract with the company's agent, under a mutual mistake as to the agent's powers, and the company refuses to perform, the subscriber can recover back his money; the contract having been part of the subscription agreement. *Weeden v. Lake Erie and M. R. R. Co.*, 14 Ohio, 563.

carrying on the business of the company, and votes on his shares; at least, when the suit is brought by the receiver of the corporation after it has become insolvent.¹

§ 519. The antecedent obligation of the corporation to perform the conditions of the subscription contract will cease if the subscribers waive performance,² or by acting as if the conditions had been performed estop themselves from setting up the non-performance of them. Thus, if a commissioner subscribes for shares in a railroad corporation to be organized and then joins in a certificate, sent to the governor of the state, which sets forth the performance of the conditions precedent, he will be estopped, in an action brought to recover his subscription, from pleading the non-performance of those conditions.³ Similarly, when the receiver of an insolvent corporation sues a shareholder on his subscription, it is no defence that the whole amount of the capital stock had never been subscribed for, if the shareholder, knowing this, has participated in the affairs of the company in a manner which would have been proper only on the assumption that the shareholders intended to carry on business with the stock but partially subscribed.⁴ The obligation on the part of the corporation to perform the conditions of a subscription contract will also cease, if the subscriber himself prevents the performance.⁵

§ 520. At times it may be difficult to determine whether a given provision in the constitution of the corporation, or in the

¹ *Musgrave v. Morrison*, 54 Md. 161.

² Defendant subscribed for shares, making his subscription payable on certain conditions, one of which was that the road should be built to a certain place by a certain date. Subsequently he gave notes for his subscription payable on the fulfilment of the conditions, except the one above mentioned. It was held that the omitted condition was thereby waived. *Slipher v. Earhart*, 83 Ind. 173. See also *Lee v. Imbrie*, 13 Oreg. 510.

³ *Bavington v. Pittsburgh and Steubenville R. R. Co.*, 34 Pa. St. 358.

⁴ *Stillman v. Dougherty*, 44 Md. 380. See also *Erie, etc. Plankroad Co. v. Brown*, 25 Pa. St. 156; *Craig v. Cumberland Valley State Normal School*, 72 Pa. St. 46; *May v. Memphis Branch R. R. Co.*, 48 Ga. 109, in which case the company did not appear to be insolvent, and sued in its own name. Compare *Somerset and K. R. Co. v. Cushing*, 45 Me. 524, 533.

⁵ See *Upton v. Hansbrough*, 3 Biss. 417, 423. Compare *Gould v. Town of Oneonta*, 71 N. Y. 298; *Perkins v. Union Button-Hole, etc. Machine Co.*, 12 Allen, 273.

subscription contract, constitutes a condition precedent to the enforcement of the subscription. The non-fulfilment, however, of that which is not a condition, is no defence to an action for calls. Thus, to a petition for a *mandamus* to compel the issue of county bonds in payment for railroad shares, it is no defence that the road had not been completed within the time mentioned in the subscription contract, time not appearing to have been of its essence, and the benefits expected from the road having accrued. The court said that if injury had resulted, there might be an abatement in the shape of damages, but not an entire release.¹ In another case where a corporation in its prospectus, set forth its intention to purchase ten tracts of land, and afterwards failed to purchase two of them, on account of a defective title, it was held that the plaintiff could not on that account rescind his contract to purchase shares, as to permit that would be a great hardship on the other shareholders.²

Provisions construed not to be conditions.

§ 521. It is the better and almost universally accepted view that a condition, in order to be operative, must be expressed in the subscription contract itself; and that any verbal condition varying the terms of the written contract is void.³ It may, indeed, be laid down as a general rule, that all parol agreements and secret understandings between the subscriber and the agent of the corporation who procures the subscription, in any way contrary to its terms, are void; and the subscription is enforceable as if no such agreements or understandings had existed;⁴ unless a fraud imputable

Verbal conditions and secret agreements void.

¹ *Kansas City, St. Jo., etc. R. R. Co. v. Alderman*, 47 Mo. 349; see *San Antonio v. Jones*, 28 Tex. 19. terms of the subscription be made a condition. *Courtright v. Deeds*, 37 Iowa, 503. See § 511.

² *Kelsey v. Northern Light Oil Co.*, 45 N. Y. 505. A tender of a stock certificate is not a condition precedent to a suit on a subscription. *Fulgam v. Macon, etc. R. R. Co.*, 44 Ga. 597. Compare *Cheltenham, etc. R'y Co. v. Daniel*, 2 Eng. R'y Cas. 728. But see *St. Paul, Stillwater, etc. R. R. Co. v. Robbins*, 23 Minn. 439. But the tender of a certificate may by the

³ *Nippenose M'f'g Co. v. Stadon*, 68 Pa. St. 256; *Miller v. Hanover Junction, etc. R. R. Co.*, 87 Pa. St. 95; *Baile v. Educational Society*, 47 Md. 117; see *Hendrix v. Academy of Music*, 73 Ga. 437. But see *Rinesmith v. People's Freight R'y Co.*, 90 Pa. St. 262.

⁴ *Galena and S. W. R. R. Co. v. Ennor*, 116 Ill. 55; *Pistaqua Ferry*

to the corporation be shown.¹ And a subscriber cannot plead that his subscription was feigned and fraudulent, and that the company was party to the fraud; for his subscription will be enforceable for the benefit of other subscribers and creditors.²

It has, however, been held that a subscription, made on a blank paper on condition that the paper should not be attached to the articles of association until they should have been presented to the subscriber for approval, does not bind him, if attached without his consent.³

§ 522. The word "non-assessable" upon a stock certificate does not impair the obligation, created by the acceptance and holding of the certificate, to pay the amount due upon the shares. At most, it is in legal effect a stipulation against liability from further assessments or taxation after the entire subscription of one hundred per cent. shall have been paid. And representations by the agent of the corporation as to the non-assessability of the shares beyond a certain percentage of their value, constitute no defence to an action

Co. v. Jones, 39 N. H. 491; *Thigpen v. Miss. Cent. R. R. Co.*, 32 Miss. 347; *Smith v. Plankroad Co.*, 30 Ala. 650; *La Grange, etc. Plankroad Co. v. Mays*, 29 Mo. 64; *Connecticut, etc. Rivers R. R. Co. v. Bailey*, 24 Vt. 465; *Downie v. White*, 12 Wis. 176; *Mississippi, etc. R. R. Co. v. Cross*, 20 Ark. 443; *New Albany, etc. R. R. Co. v. Fields*, 10 Ind. 187; *Evansville, etc. R. R. Co. v. Posey*, 12 Ind. 363; *Cunningham v. Edgefield, etc. R. R. Co.*, 2 Head (Tenn.), 23; *North Carolina R. R. Co. v. Leach*, 4 Jones L. (N. C.) 340; *Scarlett v. Academy of Music*, 46 Md. 132; *Vicksburg, etc. R. R. Co. v. McLean*, 12 La. Ann. 638; *Whitehall, etc. R. R. Co. v. Myers*, 16 Abb. Pr. N. S. (N. Y.) 34; *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286.

¹ *Martin v. Pensacola, etc. R. R.*

Co., 8 Fla. 370; *Vicksburg, etc. R. R. Co. v. McKean*, *supra*; *Mississippi, etc. R. R. Co. v. Cross*, *supra*; *Scarlett v. Academy of Music*, *supra*. See §§ 523 *et seq.*, and *Union Nat. B'k v. Hunt*, 76 Mo. 439.

² *Graff v. Pittsburgh and Steubenville R. R. Co.*, 31 Pa. St. 489; *Robinson v. Pittsburgh and Connellsville R. R. Co.*, 32 Pa. St. 334; *Phoenix Warehousing Co. v. Badger*, 6 Hun, 293, *aff'd* 67 N. Y. 294. See *Bailey v. Pittsburgh and Connellsville Gas Coal, etc. Co.*, 69 Pa. St. 334.

³ *Bucher v. Dillsburg, etc. R. R. Co.*, 76 Pa. St. 306. *Acc. Ottawa, etc. R. R. Co. v. Hall*, 1 Ill. App. 612. But in such a case it would seem that the subscriber would be bound, unless he took immediate steps to have his name removed. Compare §§ 523 *et seq.*

against the holder when he has himself failed to use due diligence to ascertain the truth or falsity of such representations.¹

§ 523. A shareholder, however, whose subscription has been induced by a fraud which may be treated as the fraud of the corporation can annul his subscription and thereby free himself from all liability, provided others have not in the meanwhile justifiably acted on the faith of his subscription under such circumstances that as between him and them responsibility for the fraud attaches to him.² Accordingly, when the receiver of an insolvent corporation sues to recover the amount unpaid on a subscription, it is then too late to plead that the subscription was induced by fraudulent misrepresentations.³ And in

Subscriptions obtained by fraud voidable, provided subscriber acts with despatch.

¹ Upton (assignee) v. Tribilcock, 91 U. S. 45. See also Hall v. Selma, etc. R. R. Co., 6 Ala. 741.

² Oakes v. Turquand, L. R. 2 H. L. 325; Cunningham v. Edgfield, etc. R. R. Co., 2 Head (Tenn.), 23; Grangers' Ins. Co. v. Turner, 61 Ga. 561; Davis v. Dumont, 37 Iowa, 47; Water Valley M'fg Co. v. Seaman, 53 Miss. 655; Rivers v. Montgomery Plank Road Co., 30 Ala. 92; Montgomery Southern Ry. Co. v. Matthews, 77 Ala. 357; City Bank v. Bartlett, 71 Ga. 797; Henderson v. Railroad Co., 17 Tex. 560; Occidental Ins. Co. v. Ganzhorn, 2 Mo. App. 205; *In re* Etna Ins. Co., *Ex parte* Shields, 7 Ir. R. Eq. 264. See Walker v. Mobile and Ohio R. R. Co., 34 Miss. 245; Waldo v. Chicago, etc. R. R. Co., 1 Wis. 575; *In re* Madrid Bank, Wilkinson's Case, 36 L. J. Eq. 489; *In re* Russian Iron Works Co., Kincaid's Case, ib. 499. Compare Rutz v. Esler, etc. M'fg Co., 3 Ill. App. 83. It has been held that in a suit brought by a corporation against a shareholder on a note, the defendant may set off money paid by him on a stock subscription induced by fraud; unless the rights

of creditors intervene. Hamilton v. Grangers' Life, etc. Ins. Co., 67 Ga. 145. To avoid a subscription on the ground of misrepresentations of the agent obtaining it, the misrepresentations must be of a fact, and not an expression of opinion, and must not relate to matters controlled by the charter, as to which the subscriber is affected with knowledge. Selma M. and M. R. R. Co. v. Anderson, 51 Miss. 829; Jackson v. Stockbridge, 29 Tex. 394; Montgomery Southern Ry. Co. v. Matthews, 77 Ala. 357. In an action by a corporation on a subscription which after its execution had been raised without knowledge of the maker, when the execution of the contract as set out is denied, the corporation cannot recover the amount due on the original subscription without showing that the alteration was not fraudulently made by it. Bery v. Marietta, P. and O. Ry. Co., 26 Ohio St., 673.

³ Upton v. Tribilcock, 91 U. S. 45; Ruggles v. Brock, 6 Hun, 164; Michener v. Payson, 13 Bankr. Reg. 49; Burgess's Case, 15 Ch. D. 507; Upton v. Englehart, 3 Dill. 496.

England, at least, a person can bring no action for damages against a corporation for fraudulent misrepresentations, which induced him to purchase shares, as long as he remains in the company, and does not offer to rescind.¹

§ 524. In regard to this exceedingly difficult question of annulling subscriptions on the ground of the fraud of corporate agents, there may be a shade of difference between the English and American views. In England a tendency has been shown to regard a contract of subscription as a contract strictly between the subscriber and the company. For instance, in *Directors v. Kisch*,² the court held that a person could dissolve a contract to take shares in a company when the inducement on its part was false, and, when not himself guilty of laches, could withdraw without regard apparently to the subsequently accruing rights of creditors, Lord Romilly saying, "that contracts of this description between an individual and a company, so far as misrepresentation or suppression of the truth is concerned, are to be treated like contracts between any two individuals."³ The American cases, on the other hand, more generally recognize that a subscription contract is one on which persons other than the contracting parties are entitled to rely.⁴

§ 525. It is submitted that to questions regarding the right to rescind a subscription contract or defend in a suit for calls, a course of reasoning somewhat like the following is applicable. In all matters within the ordinary scope of the corporate powers the corporation acting through whatever agency may constitute the corporate management represents all persons in any way interested in the corporate enterprise. Consequently, the interests of all are bound by the acts of the corporate management (say, for simplicity, by the acts of the board of directors) within the scope of its authority. But the board in no way represents persons whose interests in

Compare *Farrar v. Walker*, *ib.* 82.

² L. R. 2 H. L. 99.

See also § 744.

³ See also *Smith's Case*, L. R. 2 Ch.

¹ *Houldsworth v. City of Glasgow Bank*, 5 App. Cas. 317. See *Western City of Glasgow Bank*, 5 Ap. Cas. 317, *ante*.

Bank of Scotland v. Addie, 1 H. L. Sc. App. 145, 157; *National Exchange Co. v. Drew*, 2 Macq. 103.

⁴ See § 521, also §§ 701, 702.

respect of the corporate enterprise have not yet arisen. When A., for instance, contracts with the directors, the latter represent the persons whose interests have already accrued, *i. e.*, shareholders and existing creditors. But A., until his rights have arisen, is as to the directors an outsider, whom they in no way represent. If, in contracting with A., the directors act fraudulently, then on account of the fraud he would be allowed as between himself and those whom the directors represent, to rescind the contract; because the fraud of the agent is the fraud of the principal, and is in this case, as to A., the fraud of the corporation, and of the persons already interested in it, whom the directors represent. Moreover, within the scope of their more restricted powers, other agents, as well as directors, represent the entire mass of corporate interests.¹

§ 526. Applying this reasoning to the right of a subscriber to annul a subscription contract induced by a fraud of the agent representing the corporation in the matter, it would seem that the contract might be annulled by the subscriber acting swiftly, unless, after his subscription and before he has taken steps to annul it, some one has acted relying on it in good faith; that is, unless some one has subscribed subsequently, seeing on the books the name of the subscriber whose subscription was induced by fraud, or some one has contracted with the corporation on the credit of such fraudulently induced subscription. As to such latter persons, carrying out the course of reasoning, it would seem that the subscriber could not rescind so as to prejudice their rights in any way, for the corporate agent in his fraudulent contract with the subscriber in no way represented such persons, who afterwards acted relying on the acts of the subscriber. And if the subscription was induced by fraud, nevertheless the loss should fall on the subscriber rather than on persons who acted subsequently relying on his subscription. For the directors, when they afterwards contract with any one, represent the subscriber, and to allow him to rescind so as to affect the rights of a subsequently contracting party might visit on an innocent head the results of a fraud committed by

¹ It is not improper to regard the directors as representing creditors; see § 756.

the corporate agent on a person whom at the time of the subsequent contract the directors represent, and who, therefore, should bear the loss rather than the parties subsequently contracting.

§ 527. To subscriptions induced by error or justifiable ignorance of material facts a rule somewhat similar to the one above stated in regard to fraudulently induced subscriptions, and a course of reasoning somewhat similar to the above would apply. "Except where a person has induced others to act on his own representations, ignorance of material facts on his part affords a sufficient reason for not holding him bound by what in such ignorance he may have said or done."¹

§ 528. When a contract between two individuals is violated by one of them, the other may often acquire thereby the right to rescind; but in such case either of the contracting parties could have released the other. With regard to the contract between the subscriber and the corporation the case is manifestly different. In the first place, the corporation has ordinarily no power to release the subscriber, for numerous persons, creditors, and shareholders, have in regard to the contract rights which a release would infringe.² If the corporate management violates the contract with the subscriber by diverting the funds of the corporation to unauthorized purposes, it does an act which may violate the rights of all non-consenting persons in respect of the corporate enterprise; but this act is in itself clearly no ground on which one of these injured persons may claim a release from his obligation to the other injured persons.³

§ 529. Accordingly, after a person has subscribed for shares in the stock of a corporation he will not be released from his contract by the mismanagement of the corporate affairs;⁴ even

¹ Lindley on Part., 135. See *Salem Mill Dam Co. v. Ropes*, 9 Pick. 187; *Payson v. Withers*, 5 Biss. 269; *Four Mile Val. R. R. Co. v. Bailey*, 18 Ohio St. 208.

² See §§ 549-551.

³ The shareholder's remedy is to enjoin unauthorized acts. See *Mississippi, etc., R. R. Co. v. Cross*, 20 Ark. 443, and the following pages.

⁴ *Chetlain v. Republic Life Ins. Co.*, 86 Ill. 220; *Southern Life Ins. Co. v.*

though the mismanagement amount to such non-user or mis-user of the corporate franchises as would be a ground for the state to forfeit them.¹ Thus, an illegal election of directors will not release a subscriber;² nor a release of other shareholders by the directors; for if the release was made in pursuance of competent authority it was valid, and, if not, it was simply void.³ Similarly, a plea to an action to collect a subscription to the stock of a railroad company, that the company has sold or leased its road, is bad on demurrer; for, if the corporation had authority to sell or lease, a subscriber would not be discharged; and if it had not, the transaction was void and would not affect his rights.⁴

§ 530. When a radical change is effected, or is sought to be effected, in a corporate enterprise, through a legislative amendment to the constitution, applied for and accepted by the corporation,⁵ whether or not a dissenting shareholder is released from his subscription contract is a question involving many considerations, and in regard to it there is some conflict of authority.

Change in the corporate enterprise by legislative action.

If the change is immaterial, or is an alteration or amendment that is conducive in the main to the successful carrying out of

Lanier, 5 Fla. 110. See *Merrill v. Reaver*, 59 Iowa, 404; *Oler v. Baltimore*, etc. R. R., 41 Md. 583.

¹ *Hanover Junction*, etc. R. R. Co. v. *Haldeman*, 82 Pa. St. 36; *Connecticut*, etc. Rivers R. R. Co. v. *Bailey*, 24 Vt. 465; *Mississippi*, etc. R. R. Co. v. *Cross*, 20 Ark. 443; *Hammett v. Little Rock*, etc. R. R. Co., 20 Ark. 204; *Hannibal*, etc. Plankroad Co. v. *Menefee*, 25 Mo. 547. See *Cunningham v. Edgfield*, etc. R. R. Co., 2 Head (Tenn.), 23; *Mechanics' Building Ass'n v. Stevens*, 5 Duer (N. Y.), 676.

² *Eakright v. Logansport*, etc. R. R. Co., 13 Ind. 404. See *Western Plankroad Co. v. Stockton*, 7 Ind. 500. Compare § 540.

³ *Hall v. Selma*, etc. R. R. Co., 6

Ala. 741; *Macon*, etc. R. R. Co. v. *Vason*, 57 Ga. 314. Contra, *Rutz v. Esler*, etc. M'f'g Co., 3 Ill. App. 83 (a more than questionable case).

⁴ *Hays v. Ottawa*, etc. R. R. Co., 61 Ill. 422; *Ottawa*, etc. R. R. Co. v. *Black*, 79 Ill. 262. But see *South Georgia*, etc. R. R. Co. v. *Ayres*, 56 Ga. 230.

⁵ In order to be valid, a vote accepting an act altering the charter, should be passed at a meeting of the corporation duly convened, after notice to all the members. *Commonwealth v. Cullen*, 13 Pa. St. 133. Directors cannot bind shareholders by accepting a substantial alteration. *Brown v. Fairmount M'f'g Co.* 10 Phila. (Pa.) 32; *Marlborough M'f'g Co. v. Smith*, 2 Conn. 579; see § 227.

the originally contemplated enterprise, a shareholder is not released.¹ It is evident that in a large corporation there must be some surrender of opinion, and even of interest by a minority to the majority. This courts will recognize, and will not permit one shareholder to ruin the corporate enterprise by insisting on his finically strained rights. Thus, a subscriber is not discharged by an amendment to the charter of a railroad corporation, which merely enlarges the powers of the corporation, as, for instance, by allowing it to build a branch road;² nor is a subscriber discharged by a slight alteration in the route,³ especially if the location of the road had not been definitely fixed when he subscribed;⁴ nor by a change of the corporate name by the legislature.⁵ So subscribers are not released by an amendment extending the time for the completion of the railroad,⁶ and a subscriber cannot avoid payment because the charter has been modified so as to authorize the corporation to purchase stock in other railroads, even though the real terminus of the road is thereby changed.⁷

§ 531. On the other hand, a great number of cases hold that an alteration of the constitution effecting a radical change in

¹ *Nugent v. Supervisors*, 19 Wall. 241; *New Haven and Derby R. R. Co. v. Chapman*, 38 Conn. 56; *Union Agriculture Ass'n v. Neill*, 31 Iowa, 95; *Clark v. Monongahela Nav'n Co.*, 10 Watts (Pa.), 364; *Everhart v. Phila. etc. R. R. Co.*, 28 Pa. St. 339. As to what is a substantial amendment working a material departure from the originally contemplated enterprise no rule applicable to all cases can be laid down. *Witter v. Mississippi, etc. R. R. Co.*, 20 Ark. 463, 493.

² *Peoria, etc. R. R. Co. v. Preston*, 35 Iowa, 115.

³ *Wilson v. Wills Valley R. R. Co.*, 33 Ga. 466; see *Buffalo and Pittsburgh R. R. Co. v. Hatch*, 20 N. Y. 157. But a substantial change of the route was held to discharge a subscriber in *Middlesex Turnpike Co. v. Locke*, 8 Mass. 268; *Same v. Swan*,

10 Mass. 384; *Buffalo, Corning, etc. R. R. Co. v. Pottle*, 23 Barb. 21; *Kenosha, etc. R. R. Co. v. Marsh*, 17 Wis. 13. Especially if the subscription is conditional on its face. *Moore v. Hanover Junction R. R. Co.*, 94 Pa. St. 324.

⁴ *Eppes v. Mississippi, etc. R. R. Co.*, 35 Ala. 33.

⁵ *Bucksport, etc. R. R. Co. v. Buck*, 68 Me. 81; *Commonwealth v. Pittsburgh*, 41 Pa. St. 278, municipal subscription.

⁶ *Agricultural Branch R. R. Co. v. Winchester*, 13 Allen, 29; see *Fry's Ex'r v. Lexington, etc. R. R. Co.*, 2 Metc. (Ky.) 314; *Commonwealth v. Pittsburgh*, 41 Pa. St. 278.

⁷ *Terre Haute, etc. R. R. Co. v. Earp*, 21 Ill. 291. Compare *Pacific R. R. Co. v. Hughes*, 22 Mo. 291.

the corporate enterprise releases a shareholder from his subscription.¹ These cases proceed on the theory that the corporation cannot enforce the subscription of a dissenting shareholder while the constitution as altered remains in force; since that would be to enforce a contract which the shareholder never made.²

§ 532. Still it seems quite possible that many of these decisions are wrong on principle; at least, those of them where the charter was not amended in pursuance of a right reserved to the state to alter and repeal. For it is surely universally recognized law that a charter imports a contract between the corporation and the state; and the state cannot constitutionally pass a law radically changing it.³ Consequently, any such change unaccepted by the corporation would be plainly unconstitutional and void. But the corporation, or majority of shareholders, has no power to bind the minority by acts beyond the scope of the original chartered powers, and *à fortiori* no authority to bind them by any act causing a radical change in the corporate enterprise, as, for instance, by accepting a radical amendment to the corporate constitution.⁴ Therefore, the state having no power to amend the constitution against the consent of the corporation, and the corporation having no power to accept an amendment against the consent of any shareholder, it would seem that no shareholder should be allowed to claim a release as long as there are other non-consenting shareholders who do not wish to be

¹ *Manheim, etc. Turnpike Co. v. Arndt*, 31 Pa. St. 317; *Chartiers R'y Co. v. Hodgins*, 77 Pa. St. 187; *Caley v. Phila. and Chester R. R. Co.*, 80 Pa. St. 363; *Southern Penn. R. R. Co. v. Stevens*, 87 Pa. St. 195; *Noesen v. Town of Port Washington*, 37 Wis. 168; *Ashton v. Burbank*, 2 Dill. 435; *Bank v. City of Charlotte*, 85 N. C. 433; *Supervisors v. Mississippi, etc. R. R. Co.*, 21 Ill. 338; *Union Locks and Canals v. Towne*, 1 N. H. 44; *Marietta, etc. R. R. Co. v. Elliott*, 10 Ohio St. 57; *Thompson v. Guion*, 5 Jones, Eq. (N. C.) 113; also cases in next note. See *Fry's Ex'r v. Lexington, etc. R. R. Co.*, 2 Metc. (Ky.) 314; *Richmond Street R. R. Co. v. Reed*, 83 Ind. 9.

² *Hartford and N. H. R. R. Co. v. Crosswell*, 5 Hill (N. Y.), 383; *Middlesex Turnpike Co. v. Locke*, 8 Mass. 268; *Carlisle v. Terre Haute, etc. R. Co.*, 6 Ind. 316; *McCray v. Junction R. R. Co.*, 9 Ind. 358; *Booe v. Same*, 10 Ind. 93; *Hoey v. Henderson*, 32 La. Ann. 1069.

³ See §§ 450 *et seq.*

⁴ See *Chapman v. Mad River, etc. R. R. Co.*, 6 O. St. 119, 137; and § 557.

released, but desire to have the original corporate enterprise adhered to. The plain remedy in such a case is to enjoin the acceptance of the amendment;¹ a step which should be immediately taken, and by those shareholders who wish the original enterprise adhered to, and wish to preserve their rights against other subscribers who may dissent from the change, but, rather than enjoin it, prefer a release; as under such circumstances it would certainly be unreasonable to look to subscribers, who merely desire a release, to take the initiative in expensive litigation to enjoin a change.²

§ 533. If, however, under a power reserved to itself, the state radically changes the constitution of a corporation, it would seem that, unless the change could be held to have been contemplated by the subscriber on subscribing, such altered contract could not be enforced against him;³ for a state cannot make a contract between its citizens. Nevertheless, in order that a right to rescind result, the amendment must radically change the nature of the enterprise. For instance, it has been held in New York, that an alteration by the legislature of the charter of a plank road or railroad corporation, in pursuance of powers reserved, by changing its name, increasing its capital, and extending its road, does not discharge a subscriber from liability on his subscription.⁴ These were changes, however, which the shareholder might be held to have contemplated on subscribing. As the court said in *Buffalo and New York City R. R. Co. v. Dudley*:⁵ "The change is not fundamental. The new powers conferred are

¹ *Fry's Ex'r v. Lexington, etc. R. Co.*, 2 Mete. (Ky.) 314. See also *Mississippi, etc. R. R. Co. v. Cross*, 20 Ark. 443; *Mississippi, etc. R. R. Co. v. Gaster*, 24 Ark. 96. But see *Thompson v. Guion*, 5 Jones, Eq. (N. C.) 113.

² Where an amendment to a charter is passed by the legislature, but its acceptance is enjoined by a shareholder, subscribers remain liable; not having been injured. *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536.

³ But a shareholder (see § 502) will be estopped from objecting if he impliedly assents to the amendment by acting (as a director) under the amended charter. *Ross v. Chicago B. and Q. R. R. Co.*, 77 Ill. 134.

⁴ *Schenectady, etc. Plank Road Co. v. Thatcher*, 11 N. Y. 102; *Buffalo and N. Y. City R. R. Co. v. Dudley*, 14 N. Y. 336.

⁵ 14 N. Y. 348.

identical in kind with those originally given. They are enlarged merely, the general objects and purposes of the corporation remaining still the same. It may be admitted that under this reserved power to alter and repeal, the legislature would have no right to change the fundamental character of the corporation and convert it into a different legal being, for instance, a banking corporation, without absolving those who did not choose to be bound."

§ 534. With like effect *Durfee v. Old Colony, etc. R. R. Co.*,¹ holds that a shareholder in a corporation, the charter of which is subject to alteration and repeal, cannot maintain a bill in equity to restrain the corporation from engaging in a new enterprise in addition to that contemplated in the charter, but of the same kind, if the new enterprise is sanctioned by express legislation, and by a vote of the majority of shareholders. In this case the "new enterprise" was a considerable extension of the railroad. Giving the opinion of the court, Chief Justice Bigelow said:—

"Whatever may be the authority which is [by a reservation of the right to alter, amend, or repeal] retained by the legislature to modify or change the charters of corporations without or against their consent, there would seem to be no reason to doubt that, with the concurrence of the corporation manifested in the mode pointed out by law, the legislature may make any alteration in, or addition to the power and authority conferred by the original act of incorporation, and not foreign to the purposes and objects for which it was enacted, and which it was designed to accomplish, which may seem to be expedient or necessary. No breach of contract would be thereby occasioned. Such action would be in precise accordance with the terms on which the grant of the franchise was made. . . . The stockholder cannot say that he became a member of the corporation on the faith of an agreement made by the legislature with the corporation, that the original act of incorporation should undergo no change, except with his assent. . . . The real contract into which the stockholder enters is, that he agrees to become a member of an artificial body, which is

¹ 5 Allen, 230.

created and has its existence by virtue of a contract with the legislature, which may be amended or changed with the consent of the company, ascertained or declared in the mode pointed out by law. . . . All that we mean to determine is that the obligation of the contract which subsists between the corporation and a stockholder, by virtue of his being a proprietor of shares in the corporate stock, is not impaired by an act of the legislature which amends and alters the charter, and authorizes the corporation to undertake new and additional enterprises of a nature similar to those embraced within the original grant of power, if such act is accepted by a majority of the stockholders in the mode provided by law."¹

§ 535. A somewhat different view was taken in the New Jersey case of *Zabriskie v. Hackensack, etc. R. R. Co.*,² where Chancellor Zabriskie said:³ "There is no other alternative to the proposition that while the power reserved authorizes the legislature, within certain limits, to make such alterations as they choose to impose, it gives no authority when the legislature does not impose them, for the majority to adopt such alterations or enter upon such enterprises as are allowed by the legislature. Again the power of the legislature has its limits. It can repeal or suspend the charter; it can alter or modify it; it can take away the charter; but it cannot impose a new one, and oblige the stockholders to accept it. It can alter or modify the old one; but the power to alter or modify anything can never be held to imply a power to substitute a thing entirely different. It is not the meaning of the words in their usually received sense."

Nevertheless, it is hard to see why the power to alter and amend, the power to *impose* new terms, does not include the power to make the alteration subject to the will of a majority of the shareholders. What the legislature could do without the assent of this majority it surely could do with it, and in this respect *Durfee v. Old Colony, etc. R. R. Co.* is more satisfactory than *Zabriskie v. Hackensack, etc. R. R. Co.*⁴

¹ *Durfee v. Old Colony, etc. R. R. Co.*, 5 Allen, 230, 243 *et seq.* See Atchison T. and S. F. R. R. Co. v. Fletcher, 35 Kan. 236.

² 18 N. J. Eq., 178.

³ *Ib.*, 192.

⁴ See also *Bish v. Johnson*, 21 Ind. 299.

§ 536. Without special authority a corporation cannot consolidate with another; and an attempted wrongful consolidation may be enjoined by a shareholder, like any other *ultra vires* act.¹ Nevertheless, that an unauthorized consolidation, if actually effected, will release a dissenting subscriber, has been held in more than one instance.² Every subscription, however, must be regarded as made with reference to any statute in force at the time allowing consolidation, and therefore by a consolidation will not be released;³ and if the original subscriptions were conditional, the consolidated company may entitle itself to sue by performing the condition.⁴ Further, when a corporation is formed under a law respecting which the right to alter and repeal is reserved to the state, a consolidation authorized by an amendment will not release a subscriber, when the consolidation takes place with

Effect of
consolidation.

¹ *Mowrey v. Indianapolis, etc. R. R. Co.*, 4 Biss. 78. See §§ 419 *et seq.*

² *McCray v. Junction R. R. Co.*, 9 Ind. 358; *State v. Bailey*, 16 Ind. 46; *Shelbyville, etc. Turnpike Co. v. Barnes*, 42 Ind. 498.

A railroad company authorized to do so, may transfer its property to another company and dissolve; thus effecting a consolidation. A shareholder cannot prevent this, as he cannot prevent the majority from dissolving. But he cannot be forced into a new enterprise, nor can he be compelled to take in payment for his stock the stock of the consolidated company, and he may enjoin the proceeding until he has received security. *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 42. See *Hamilton Mut. Ins. Co. v. Hobart*, 2 Gray, 543; *Gardner v. Hamilton Mut. Ins. Co.*, 33 N. Y. 421.

When a consolidation is effected wrongfully, and against the protest of a shareholder who has partially paid up his shares, the consolidated com-

pany is liable to him for the value of them. *International, etc. R. R. Co. v. Bremond*, 53 Tex. 96. See §§ 323, 324.

³ *Bish v. Johnson*, 21 Ind. 299; *Sparrow v. Evansville, etc. R. R. Co.*, 7 Ind. 369; *Edwards v. People*, 88 Ill. 340; *Mansfield, etc. R. R. Co. v. Brown*, 26 Ohio St. 233; compare *Same v. Stout*, *ib.* 241. Otherwise, if the consolidation effects a radical change in the nature of the enterprise, and a practical abandonment of the original scheme. *Illinois Grand Trunk R. R. Co. v. Cook*, 29 Ill. 237. Where a corporation, without authority, issues a scrip dividend in fraud of another corporation with which it was about to consolidate, the scrip may be declared void at the suit of shareholders in the latter corporation; and even *bona fide* purchasers of the scrip may have to return it. *Bailey v. Citizens' Gas Light Co.*, 27 N. J. Eq. 196.

⁴ *Mansfield, etc. R. R. Co. v. Stout*, 26 O. St. 241.

another corporation of the same character, and does not work a fundamental change in the nature of the original objects of incorporation.¹

§ 537. When a person has subscribed for shares in a *de facto* existing corporation, he cannot plead to a suit brought on his subscription that there are irregularities in the organization of the company; even though the irregularities are such as would be fatal on a *quo warranto*.²

When subscriber cannot plead nul tiel corporation.

Thus, it is no defence to an action by a railroad corporation to recover a subscription that the articles of association were defective in not stating definitely the termini of the road and the counties through which it passed.³ Moreover, the signature of the defendant to a subscription to shares in the stock of an alleged corporation reciting that a corporation had been formed under the general enabling act, and that articles of association with the necessary affidavits had been filed, is conclusive evidence of incorporation as against such subscriber.⁴

§ 538. When, however, a person signs articles of association and subscribes for shares, the organization of the corporation not being at the time completed, he is not afterwards estopped thereby from pleading to an

When he may.

¹ *Sprague v. Illinois River R. R. Co.*, 19 Ill. 174; *Hanna v. Cincinnati, etc. R. R. Co.*, 20 Ind. 30. See *Bishop v. Brainerd*, 28 Conn. 289. Compare *Illinois River R. R. Co. v. Zimmer*, 20 Ill. 654.

² *Chubb v. Upton, Assignee*, 95 U. S. 665; *Sanger v. Upton, Assignee*, 91 U. S. 56; *Home Stock Ins. Co. v. Sherwood*, 72 Mo. 461; *Monroe v. Fort Wayne, etc. R. R. Co.*, 28 Mich. 272; *Montpelier, etc. R. R. Co. v. Langdon*, 46 Vt. 284; *McCarthy v. Lavashe*, 10 Chi. Leg. N. 342; *Ossipee Hosiery, etc. Co. v. Canney*, 54 N. H. 295; *McHose v. Wheeler*, 45 Pa. St. 32; *Freeland v. Pennsylvania Central Ins. Co.*, 94 Pa. St. 504; *Buffalo, etc. R. R. Co. v. Cary*, 26 N. Y. 75; *Eaton v. Aspinwall*, 19 N. Y. 120; *Mead v. Keeler*, 24 Barb. 20;

see *Oregon Central R. R. Co. v. Scoggin*, 3 Ore. 161; *Hunt v. Kansas, etc. Bridge Co.*, 11 Kans. 412. A subscriber to shares, who has accepted the charter and assisted in putting it in operation, cannot plead to a suit on his subscription that the charter had been obtained by fraud. *Smith v. Heidecker*, 39 Mo. 157. See *Slocum v. Providence Steam and Gas Pipe Co.*, 10 R. I. 112; *Slocum v. Warren*, ib. 116. Compare *Occidental Ins. Co. v. Ganzhorn*, 2 Mo. App. 205. See also §§ 738, and 145 *et seq.*

³ *Cayuga Lake R. R. Co. v. Kyle*, 64 N. Y. 185.

⁴ *Black River, etc. R. R. Co. v. Clarke*, 25 N. Y. 208. Compare *Road Co. v. Creeger*, 5 Har. & J. (Md.) 122; *St. Charles M'fg Co. v. Britton*, 2 Mo. App. 290.

action on his subscription, that the steps necessary to complete the organization of the corporation have not been taken.¹ "The 'ground upon which a party who has contracted with a corporation as such is estopped to deny its existence is, that by his contract he has recognized the existence of the corporation. The contract in question, instead of purporting to be made with an existing corporation, utterly excludes the idea of present existence, but contemplates the future organization of the corporation to which he was to pay the amount of his subscription."²

§ 539. On not dissimilar principles a subscriber to the stock of a railroad corporation may, in a suit brought against him for assessments by a new corporation formed by the consolidation of the original corporation with another, question the consolidation proceedings in which he has taken no part, although they be sufficient to constitute the consolidated company a corporation *de facto*.³ For in an action brought by a consolidated corporation to recover subscriptions to the stock of one of the original corporations based on the right of succession under the statute, it is essential that a consolidation in accordance with the statute be proved; and it is not enough that the consolidated company be shown to be a corporation *de facto*.⁴

§ 540. To a suit for calls, unless affected with some special estoppel, a shareholder may plead that the officers making them were not legally officers of the corporation. Accordingly, where the notice of a meeting contained nothing about electing directors, directors chosen at that meeting are not validly elected, and an

Shareholder may plead that officers making calls are not legally elected.

¹ Rikhoff v. Brown's Sewing Machine Co., 68 Ind. 388; Indianapolis Furnace, etc. Co. v. Herkimer, 46 Ind. 142; see Knight v. Flatrock, etc. Turnpike Co., 45 Ind. 134.

² Indianapolis Furnace, etc. Co. v. Herkimer, 46 Ind. 142, 149.

It has been held that a shareholder is not estopped by his subscription to deny the lawful existence of a corporation prohibited by the state consti-

tution. St. Louis Colonization Ass'n v. Hennessy, 11 Mo. App. 555. Contra, McCarthy v. Lavashe, 10 Chic. Leg. N. 342.

³ Tuttle v. Michigan Air Line R. R. Co., 35 Mich. 247. See Rodgers v. Wells, 44 Mich. 411.

⁴ Mansfield, etc. R. R. Co. v. Drinker, 30 Mich. 124; Same v. Brown, 26 Ohio St. 223; Same v. Stout, ib. 241.

assessment or call made by them is void. These facts a shareholder may plead.¹

§ 541. When a corporation increases its capital stock and issues further shares, a subscriber to them, when sued on his subscription, cannot avail himself of any irregularities in their issue, if he has acquiesced or taken part in the proceedings by which they were issued,² or has paid voluntarily an assessment on his new shares,³ or has subscribed subsequently to their issue and may be presumed to have waived any irregularities.⁴ But when the subscriber has done nothing by which he may be held estopped, he may decline to receive stock improperly issued,⁵ and may be in a position to defend in a suit brought to enforce his subscrip-

¹ *People's Mut. Ins. Co. v. Westcott*, 14 Gray, 440. Accord, *Howbeach Coal Co. v. Teague*, 5 H. & N. 151. Compare *Ginrich v. Patrons' Mill Co.*, 21 Kan. 61; and § 529.

In a suit to recover a subscription it will be presumed, in the absence of proof to the contrary, that the meeting of directors authorizing the assessment was legally noticed. *Chouteau Ins. Co. v. Holmes*, 68 Mo. 601; see also § 190.

² *Clarke v. Thomas*, 34 Ohio St. 46; *Kansas City Hotel Co. v. Harris*, 51 Mo. 464. So a transferee, even one who has taken the shares as collateral, may be estopped. *Pullman v. Upton*, 96 U. S. 328.

³ *Delano v. Butler*, 118 U. S. 634.

⁴ *Kansas City Hotel Co. v. Hunt*, 57 Mo. 126.

⁵ See *American Tube Works v. Boston Machine Co.*, 139 Mass. 5; *Reed v. Boston Machine Co.*, 141 Mass. 454. Holders of increased shares have no standing in court to contest the validity of other (preferred) shares issued at the same time, on the ground that formalities required by the statute authorizing the increase had not been

complied with. *Columbia National Bank's Appeal*, 16 Weekly Notes of Cases (Pa.), 357. A sale of stock in a railroad company by the directors at a less rate than that fixed by the charter is a fraud in law. The issuing of a bond convertible into stock has the same effect as issuing stock; and the sale of such a bond at a discount is unlawful; and this though the charter contain no prohibition against taking a subscription at less than the charter price. These facts constitute a defence to an action on an executory contract to take such stock, when the subscriber has acted in good faith and without notice. *Sturges v. Stetson*, 1 Biss. 246. Compare *Fosdick v. Sturges*, 1 Biss. 255; *Hollingshead v. Woodward*, 35 Hun (N. Y.), 410. When a statute exists forbidding the issue of shares below par, and declaring void shares so issued, a subscriber to stock at less than par is in *pari delicto* with the corporation and cannot sue on the contract to force it to issue such stock to him, nor can he sue to recover back moneys paid on account. *Clarke v. Lincoln Lumber Co.*, 59 Wis. 655. Compare § 545.

tion to it.¹ Further, when the capital stock is limited by the charter, all stock issued in excess of such limit is void, and a holder thereof is not entitled to the rights of a shareholder,² nor is he estopped from setting up its invalidity as a defence to an action in the interest of creditors, brought to recover the balance unpaid thereon.³ But when the corporation has become bankrupt, the holder of void stock is not entitled to have money paid thereon applied as a credit on the unpaid balance due on authorized stock held by him.⁴ In an action by a corporation to recover a subscription, the fact that it has taken subscriptions in excess of its limit does not itself bar a recovery, if the corporation has retained a sufficient amount of its authorized stock which it is ready and able to issue.⁵

§ 542. Insolvency of the corporation is no defence to a suit brought to collect a subscription.⁶ And the assignee or receiver of the corporation succeeds to all its rights and may recover unpaid subscriptions for the benefit of shareholders and creditors.⁷ But a receiver cannot enforce the payment of a subscription which the corporation could not have enforced at the time of his appointment;⁸ for the corporation or corporate management, just as much as a receiver, represents the interests of all persons, creditors as well as shareholders, the main difference being that, as

Insolvency of corporation no defence. Capacities of receiver.

¹ See last note.

² *New York and N. H. R. R. Co. v. Schuyler*, 34 N. Y. 30; *Scoville v. Thayer*, 105 U. S. 143; *Oler v. Balto. and Randallstown R. R. Co.*, 41 Md. 583; *Grangers' Life, etc. Ins. Co. v. Kamper*, 73 Ala. 325.

³ *Scoville v. Thayer, supra*; *Clark v. Turner*, 73 Ga. 1.

⁴ *Scoville v. Thayer, supra*.

⁵ *Oler v. Balto. and Randallstown R. R. Co.*, 41 Md. 583. That the corporation has illegally increased its stock, is no defence to a note given for a subscription, when it is not alleged that the illegal cannot be distinguished from the legal stock. *Merrill v. Reaver*, 50 Iowa, 404.

⁶ *Dill v. Wabash Valley R. R. Co.*, 21 Ill. 91. It is no defence to a suit on a subscription to its stock, brought by a railroad company, that the governor of the state had seized the road. *Mullins v. North and South R. R. Co.*, 54 Ga. 580. The fact that a railroad has not been and is not likely to be completed is no defence to an action on an unconditional subscription. *Smith v. Gower*, 2 Duv. (Ky.) 17.

⁷ *Sawyer v. Hoag*, 17 Wall. 610. *Upton v. Tribilcock*, 91 U. S. 45; *Shockley v. Fisher*, 75 Mo. 498; *Lionberger v. Broadway S'v'gs B'k*, 10 Mo. App. 499.

⁸ *Cutting v. Damerel*, 88 N. Y. 410; *Billings v. Robinson*, 28 Hun, 122.

a receiver is ordinarily appointed only when the corporation is insolvent, the rights of creditors in the corporate funds are then especially prominent; and a receiver is more apt to be regarded as the representative of creditors.¹ "A receiver is appointed upon a principle of justice for the benefit of all concerned. Every kind of property of such a nature that, if legal, it might be taken on execution, may, if equitable, be put into his possession. Hence the appointment has been said to be an equitable execution. He is virtually a representative of the court, and of all the parties in interest in the litigation wherein he is appointed."²

It has been held that to a suit by a receiver to collect an unpaid subscription, a shareholder may aver that the receiver was improperly appointed by a decree not binding on the shareholder.³ But this doctrine may perhaps be of questionable correctness, or at least application, since the shareholder could have intervened in the proceeding by which the receiver was appointed.⁴

§ 543. The discretionary authority of directors to make calls

Directors cannot delegate authority to make calls. When calls unnecessary.

cannot be delegated, for instance, to the treasurer of the corporation.⁵ And there is also a case in which it is said that although a corporation may assign a call already due on a stock note, it cannot commit to the assignee the discretion of making future calls.⁶

But the scope of this remark, if sound at all, is very limited, for after a corporation is insolvent, and has ceased to be a going concern, that a call should be made by the corporate authorities is no longer pre-requisite to the collection of a sub-

¹ A receiver represents not only the corporation, but also creditors and shareholders, and in his character of trustee for the latter, may disaffirm illegal and fraudulent transfers of corporate property, and recover its funds and securities misapplied. *Attorney-General v. Guardian Mut. Ins. Co.*, 77 N. Y. 272. Compare *Ellis v. Little*, 27 Kan. 707.

² *Davis v. Gray*, 16 Wall. 203, 218.

³ *Chandler v. Brown*, 77 Ill. 333.

⁴ *Schoonover v. Hinckley*, 48 Iowa, 82.

⁵ *Silver Hook Road v. Greene*, 12 R. I. 164. See §§ 233, 234.

⁶ *Schultz v. Sutter*, 3 Mo. App. 137. After the whole amount of the subscription has been called, it may be assigned. *Wells v. Rogers*, 50 Mich. 294; *Schultz v. Sutter*, *supra*. See *Morris v. Cheney*, 51 Ill. 451.

scription:¹ and an insolvent corporation can include in an assignment for the benefit of creditors its right to the unpaid balance of subscriptions for which no call has been made.²

§ 544. It has also been held that in the absence of special authorization, a railroad company cannot purchase subscription notes given by shareholders in another corporation, and enforce them against the subscribers; and the fact that one railroad company has bought the road-bed of another, intending to complete the road, gives the purchaser no right to buy and enforce the vendor's stock subscriptions.³

§ 545. In payment for its shares a corporation, unless prohibited by statute,⁴ may receive any property which it is authorized to purchase, and if property (or services) so received is fairly equivalent to the par value of the shares for which it is taken, the shares will have the *status* of full-paid stock.⁵ Such transactions

Corporation may receive property in payment for its shares.

¹ See § 703.

² *Eppright v. Nickerson*, 78 Mo. 482. Compare *Wooldridge v. Holmes*, 78 Ala. 568.

³ *West End R. R. Co. v. Dameron*, 4 Mo. App. 414. See also *Minneapolis Harvester Works v. Libbey*, 24 Minn. 327. Compare *Wells v. Rodgers*, 50 Mich. 294.

⁴ See *Baile v. Educational Society*, 47 Md. 117.

⁵ *Coffin v. Ransdell*, 110 Ind. 417; *Searight v. Payne*, 6 Lea (Tenn.), 283; *Boynton v. Hatch*, 47 N. Y. 225; *Peck v. Coalfield Coal Co.*, 11 Ill. App. 88; *Chouteau v. Dean*, 7 Mo. App. 210; *Drummond's Case*, L. R. 4 Ch. 772. Payment of stock subscriptions "may be in whatever, considering the situation of the corporation, represents to that corporation a fair, just, lawful, and needed equivalent for the money subscribed." *Liebke v. Knapp*, 79 Mo. 22. A subscriber may pay for stock of a corporation organized to build a bridge across the Mississippi River by

publishing its articles and favoring the project in his newspaper. *Liebke v. Knapp*, *supra*; *Van Cott v. Van Brunt*, 82 N. Y. 535, appears to hold that if a person pays in services or otherwise an amount equal to the *actual value* of the shares received by him in return, they will be treated as fully paid up, without regard to whether the actual value was equal to their par value or not. If this case is authority for the above proposition, it points to the conclusion that a corporation may issue its stock (as fully paid up) below par; which certainly contravenes the fundamental doctrine of corporation law, that the nominal capital stock of the corporation is held out to all the world as its actual capital, and every one is entitled to contract with the corporation on the assumption either that it has actually been paid in or that it may be reached. See §§ 654, 655. Without special statutory authority no assessment can be imposed on the fully paid up stock.

may be opened to show fraud, and if the property received is grossly unequal in value to the par value of the shares, the shareholder who received the shares originally, or his subsequent transferee with notice of the circumstances, may be compelled to make up the difference in value in a suit brought by or on behalf of persons injured thereby.¹ It is manifestly incompetent for the corporate management to agree with a shareholder that shares issued to him for a nominal consideration shall be treated as fully paid up.² But the equivalency of the property taken to the par value of the shares cannot (unless some statute warrants a contrary doctrine³) be inquired into when the shares as fully paid have come into the hands of a *bona fide* purchaser who has no notice of the value of the property originally given for them.⁴

§ 546. The corporation or the corporate management may forfeit shares for non-payment of calls, when power to do so is given by the constitution of the corporation.⁵ Since, however, by a valid forfeiture of shares the relations between the shareholder and the corpo-

Forfeiture
of shares
for non-
payment of
calls.

Atlantic De Laine Co. v. Mason, 5 R. L. 463. See § 541, notes.

A contract by a corporation to sell its stock below par has been held valid on the face of it; when it did not appear how the corporation had acquired the stock, and could not be inferred that it was not fully paid stock subsequently acquired. *Otter v. Brevoort Petroleum Co.*, 50 Barb. 247.

¹ *Jackson v. Traer*, 64 Iowa 469; *Bailey v. Pittsburgh and Connellsville Gas Coal and Coke Co.*, 69 Pa. St. 334; *Boynton v. Hatch*, 47 N. Y. 225; *Tallmadge v. Fishkill Iron Co.*, 4 Barb. 382; see *Foreman v. Bigelow*, 4 Clifford, 508, 543; *Pell's Case*, L. R. 5 Ch. 11. See especially §§ 700 *et seq.*

² *Ex parte Damill*, 1 De G. and J. 372; *Dent's Case*, L. R. 15 Eq. 407; *Bailey v. Pittsburgh and Connellsville*

Gas Coal and Coke Co., 69 Pa. St. 334.

³ See § 723.

⁴ *Phelan v. Hazard*, 5 Dillon, 45; *Steady v. Little Rock, etc. R. R. Co.* ib. 348; *Foreman v. Bigelow*, 4 Clifford, 508; *McCracken v. McIntyre*, 1 Duv. (Canada), 479. See *Waterhouse v. Jamieson*, L. R. 2 H. L. Scotch. 29. And see § 702.

⁵ A corporation cannot by a by-law subject shares to forfeiture, unless the power is expressly granted. *Matter of Long Island R. R. Co.*, 19 Wend. 37; compare *Bergman v. St. Paul Mutual Building Association*, 29 Minn. 275; *Gorman v. Guardian Savings Bank*, 4 Mo. App. 180. But it has been held that a stock corporation not having express power to declare a forfeiture of shares for non-payment of calls, may sue for the amount due, and

ration are terminated, the corporation can maintain no subsequent action for calls.¹ But the power to forfeit as long as unexercised does not impliedly preclude the corporation from suing for calls instead of declaring a forfeiture.²

§ 547. To the validity of a forfeiture of shares it is essential that all the conditions precedent should have been strictly complied with.³ A reasonable notice, which should specify the place of sale,⁴ must first be given to the delinquent shareholder;⁵ and all statutory provisions, and provisions in the by-laws, that may apply regulating the nature and contents of the

on failure to collect on its judgment the whole amount, may collect the residue by a sale of the shares. *Chase v. Railroad Co.*, 5 Lea (Tenn.), 415.

¹ *Small v. Herkimer M'f'g Co.*, 2 N. Y. 330. When a corporation forfeits shares, it cannot recover on a note given for a prior unpaid assessment. *Ashton v. Burbank*, 2 Dill. 435. The power to sue a shareholder, after a forfeiture, may be given by statute. *Lexington, etc. R. R. Co. v. Chandler*, 13 Metc. (Mass.) 311; *Troy, etc. R. R. Co. v. Newton*, 1 Gray, 544; *Great Northern R'y Co. v. Kennedy*, 4 Exch. 417.

² *Delaware, etc. Navigation Co. v. Sansom*, 1 Binn. (Pa.) 70; *Freeman v. Winchester*, 18 Miss. 577; *Goshen Turnpike Road v. Hurin*, 9 Johns. 217; *Dutchess Cotton Manufactory v. Davis*, 14 Johns. 238; *New Hampshire Central R. R. Co. v. Johnson*, 30 N. H. 390; *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536; *Beene v. Cahawba, etc. R. Co.*, 3 Ala. 660; *Selma, etc. R. R. Co. v. Tipton*, 5 Ala. 787; *Instone v. Frankfort Bridge Co.*, 2 Bibb (Ky.), 576; *Mann v. Cooke*, 20 Conn. 178; *Stokes v. Lebanon, etc. Turnpike Co.*, 6 Humph. (Tenn.) 241; *Troy Turnpike and R. R. Co. v. M'Chesney*, 21 Wend. 296; *Buffalo and N. Y. City R. R. Co. v.*

Dudley, 14 N. Y. 336; *Sagory v. Dubois*, 3 Sandf. Ch. (N. Y.) 466.

Contra (*semble*) *Chester Glass Co. v. Dewey*, 16 Mass. 94; though the doctrine of this case is rather to the effect that there is no implied promise to pay, than that any implied promise is excluded by an express power of forfeiture. See also *Franklin Glass Co. v. Alexander*, 2 N. H. 380; *Giles v. Hutt*, 3 Exch. 18; *Richboro Dairymen's Association v. Ryan*, 16 Weekly Notes (Pa.), 383. Where the charter of a railroad company provides that on the failure of subscribers to pay calls, the company may sell the shares at public auction, and sue the subscriber for the balance, if any; the company may sue the subscriber without making such sale. *Western R. R. Co. v. Avery*, 64 N. C. 491.

³ *Johnson v. Lyttle's Iron Agency*, 46 L. J. Eq. 786; see *Germantown, etc. R. R. Co. v. Fitler*, 60 Pa. St. 124; *Mitchell v. Vermont M'g Co.*, 40 N. Y. Super. Ct. 406; *Eastern Plank Road Co. v. Vaughan*, 20 Barb. 157; *Knight's Case*, L. R. 2 Ch. 321.

⁴ *Lexington, etc. R. R. Co. v. Staples*, 5 Gray, 520.

⁵ *Lewey's Island R. R. Co. v. Bolton*, 48 Me. 451; *Hughes v. Antietam M'f'g Co.*, 34 Md. 317; *Matter of Long Island R. R. Co.*, 19 Wend. 37.

notice,¹ and the manner of conducting the sale must be strictly followed.² A forfeiture declared by illegally chosen directors may be set aside;³ or one declared by a board composed of a less number of directors than are authorized by the articles of association to transact business for the company.⁴ And a sale of shares for the non-payment of several assessments, one of which is illegal, is void.⁵

§ 548. The option to declare a forfeiture rests with the corporation, and cannot be exercised by the delinquent shareholder.⁶ “The power to forfeit, like the power to manage all the affairs of the corporation, is vested in the directors, upon the assumption that they will exercise it in the best manner practicable for the promotion of the interests of the company and its creditors; that they will not forfeit the stock unless the interest of all will be promoted thereby. Should they forfeit it for the purpose of defrauding the corporation, or any creditor, such forfeiture would, for that reason, be set aside.”⁷

§ 549. It is incompetent for the directors,⁸ or for the body corporate,⁹ to permit the holder of partially paid-up shares, or shares to the ownership of which individual liability attaches, to withdraw in any way not authorized by the constitution of the corporation. Such per-

Collusive
forfeitures.

Release of
subscriber
void.

¹ *Watson v. Eales*, 23 Beav. 294; *Van Diemen's Land Co. v. Cockerell*, 1 C. B. N. S. 732.

² *Portland, etc. R. R. Co. v. Graham*, 11 Metc. (Mass.) 1; *York, etc. R. R. Co. v. Ritchie*, 40 Me. 425.

³ *Garden Gully M'g Co. v. McLister*, L. R. 1 App. Cas. 39.

⁴ *In re Alma Spinning Co.*, 29 W. R. 133.

⁵ *Stoneham Branch R. R. Co. v. Gould*, 2 Gray, 277; *Lewey's Island R. R. Co. v. Bolton*, 48 Me. 451.

⁶ *Klein v. Alton, etc. R. R. Co.*, 13 Ill. 514; *Railroad Co. v. Rodrigues*, 10 Rich. L. (S. C.) 278.

⁷ *Mills v. Stewart*, 41 N. Y. 384, 390. Collusive forfeitures may be set aside. *Richmond's Case*, 4 Kay & J.

305, 323; *Gower's Case*, L. R. 6 Eq. 77; *In re St. Marylebone B'k'g Co.*, *Stanhope's Case*, 3 De G. & Sm. 198.

⁸ *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286; *Hughes v. Antietam M'f'g Co.*, 34 Md. 316; *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29; *Hall's Case*, L. R. 5 Ch. 707. See *Thomas's Case*, L. R. 13 Eq. 437.

A plea to an action on a subscription that the directors released the defendant, is bad on demurrer, unless it avers a consideration, and that there were no creditors of the corporation at the time. *Zirkel v. Joliet Opera House Co.*, 79 Ill. 334.

⁹ See *Mann v. Cooke*, 20 Conn. 178, 188.

mission is plainly *ultra vires*, and will ordinarily affect the rights only of those assenting to it. The question, whether the release or withdrawal of a shareholder is valid, may arise between the withdrawing shareholder and the corporation; or formally between such shareholder and other shareholders;¹ or between such shareholder and creditors of the corporation;² or, finally, as is frequently the case, between such shareholder and a receiver or assignee of the corporation when insolvent, who represents creditors as well as shareholders.³

§ 550. A leading English case in point is *Spackman v. Evans*.⁴ There the directors granted to a dissenting shareholder leave to retire from the company on conditions which they deemed prudent and advantageous to be granted in his case, but which were not in accordance with the deed of settlement. The shareholder performed the conditions, his name was for years removed from the list of shareholders, the company changed its business without his knowledge, and dividends were received, in which he did not participate. Nevertheless, it was held that his name should be inserted in the list of contributories on the final winding up of the company.⁵

So in *Tuckerman v. Brown*,⁶ where for the purpose of increasing the capital stock of the corporation to the amount required by law, in order that the corporation might pass the examination of the commissioners appointed by the comptroller, a premium note was given upon an agreement that after the examination the note might be withdrawn and a lesser one substituted, it was held that the agreement was a fraud, and that the maker of the note continued liable thereon, although it had been withdrawn and destroyed.⁷

¹ See § 779.

² As in *Slee v. Bloom*, 19 Johns. (N. Y.) 456.

³ *E. g.*, as in *Upton v. Tribilcock*, 91 (U. S.) 45.

⁴ L. R. 3 H. L. 171.

⁵ The decision in *Spackman v. Evans* is perhaps extreme, and Lords St. Leonard and Romilly dissented. In this case the real rights demanding the insertion of defendant's name as a

contributory were those of the shareholders who had not consented to his withdrawal (though they might have been estopped by their laches) and those of creditors. In such cases, however, the rights of creditors seem to be less regarded in England than with us. See *Dixon's Case*, L. R. 5 Ch. 79.

⁶ 33 N. Y., 297.

⁷ It was held in *Teasdale's Case*, L. R. 9 Ch. 54, that a company might by

§ 551. A person who has subscribed for shares cannot annul his subscription by giving notice to the agent with whom he contracted.¹ The circumstances of a late Pennsylvania case, which may be regarded as authority on this point, were noteworthy. A person was active in soliciting subscriptions to build a railroad. He took a subscription book from the agent of the company, subscribed therein, persuaded others to do so, and kept the book about six months. Then, because of a difference with the company's agent in regard to his remuneration, he cut out his own name, and returned the book to the company. The company sued him on his subscription, and it was held, that he had perfected a contract with the company and was bound as much as if he had left his name in the book.²

§ 552. If the corporation is in failing circumstances, or if for any other reason it cannot legally acquire its own shares, a shareholder will not avoid any liability he may be subject to, by surrendering his shares to it; even though the corporation reissue them;³ and whatever money or property he receives from the corporation in payment for his shares transferred to it, he will hold subject to the claims of its creditors.⁴

§ 553. As against all persons, so as against the individual shareholders, or a minority of shareholders, the corporation has the right to carry on the corporate enterprise in the manner and for the purposes set forth in its constitution; and within the scope of their powers the reasonable and fair discretion of the board of directors can be controlled, if at all, only through action of a majority of shareholders taken in the manner indicated by the

Purchase of shares by the corporation.

Right of the corporation to control the corporate enterprise.

special resolution vary its articles so as to give itself the power to accept surrenders of old shares in exchange for new.

¹ *Lowe v. E. and K. R. R. Co.*, 1 Head (Tenn.), 659; *Rider v. Morrison*, 54 Md. 429.

² *Greer v. Chartiers R'y Co.*, 96 Pa. St. 391.

³ *Matter of Reciprocity Bank*, 22 N. Y. 9. For the power of a corporation to purchase its own shares, see § 134, and for the effect of such a purchase on the relations between the shareholder and creditors, see § 747.

⁴ *Crandall v. Lincoln*, 52 Conn. 73,

corporate constitution.¹ "Each and every shareholder contracts that the will of the majority shall govern in all matters coming within the limits of the act of incorporation; and in cases involving no breach of trust, but only error or mistake of judgment on the part of directors who represent the company, individual stockholders have no right to appeal to the courts to dictate the line of policy to be pursued by the corporation."²

Or, as Chief Justice Bigelow said in *Durfee v. Old Colony Railroad Co.*:³ "We suppose it may be stated as an indisputable proposition, that every person who becomes a member of a corporation aggregate by purchasing and holding shares, agrees by necessary implication that he will be bound by all acts and proceedings within the scope of the powers and authority conferred by the charter, which shall be adopted and sanctioned by a vote of the majority of the corporation duly taken and ascertained according to law. This is the unavoidable result of the fundamental principle that the majority of shareholders can regulate and control the lawful exercise of the powers conferred on a corporation by its charter. A holder of shares in an incorporated body, so far as his individual rights and interests may be involved in the doings of the corporation, acting within the legitimate sphere of its corporate power has no legal control over them than that which he can exercise by his single vote in the meetings of the company."⁴

§ 554. Accordingly, a court will not ordinarily interfere with the corporate management in matters respecting the internal administration of the corporate affairs;⁵ nor examine into the affairs of a corporation to determine the expediency of its action, or its motives, as long

Courts will not interfere at the suit of shareholders.

¹ *Gravenstine's Appeal*, 49 Pa. St. 310; *Smith v. Prattville M'fg Co.*, 29 Ala. 503. See chap. 12.

² *Dudley v. Kentucky High School*, 9 Bush (Ky.), 576, 578.

³ 5 Allen, 230, 242. See § 534.

⁴ See also *Newhall v. Galena, etc. R. R. Co.*, 14 Ill. 273; *Joslyn v. Pacific Mail S. S. Co.*, 12 Abb. Pr. N. S. (N. Y.) 329; *Gifford v. New Jersey R. R. Co.*, 10 N. J. Eq. 171, 174;

New Orleans, etc. R. R. Co. v. Harris, 27 Miss. 517, 537.

⁵ *Carlen v. Drury*, 1 Ves. & B. 154; *Foss v. Harbottle*, 2 Hare, 461; *Mozley v. Alston*, 1 Phil. 790; *Bailey v. Birkenhead, etc. R'y Co.*, 12 Beav. 433; *Bach v. Pac. Mail S. S. Co.*, 12 Abb. Pr. N. S. (N. Y.) 373. See 2 *Lindley on Part.*, 895-902; *Hawes v. Oakland*, 104 U. S. 450. The power of a shareholder to sue on a right of

as the action itself is lawful.¹ And a shareholder cannot enjoin the corporation from doing what is in direct furtherance of the objects of its incorporation and beneficial to shareholders as such, because the contemplated action will injure him in another character.²

§ 555. To warrant the interference of a court, at the instance of a shareholder, to restrain an act intended by the body corporate or the corporate management, the act should be beyond the corporate powers; or, if intended by the corporate management, a manifestly improper act which the body corporate is not in a position to prevent, owing perhaps to the fact that the management cannot be changed in time.³

Unless to
restrain
acts which
are *ultra*
vires, or
constitute
a breach of
trust.

The reasons for this are thus stated in *Foss v. Harbottle*:⁴ “Whilst the court may be declaring the acts complained of to be void at the suit of the present plaintiffs, who in fact may be the only proprietors who disapprove of them, the governing body of proprietors may defeat the decree, by lawfully resolving upon the confirmation of the very acts which are the subject of the suit. . . . In order then that the suit may be sustained, it must be shown either that there is no such power as I have supposed remaining in the proprietors, or at least that all means have been resorted to and found ineffectual to set that body in motion.”⁵

§ 556. The legal effect of *ultra vires* acts was discussed in a previous chapter.⁶ A single shareholder has ample power to restrain the corporation from diverting the corporate funds from the purposes for which they were subscribed, and ordi-

action belonging to the corporation is discussed in §§ 138 *et seq.*

¹ *Oglesby v. Attrill*, 105 U. S. 605. See *Mayor, etc. of Baltimore v. Baltimore and O. R. R. Co.*, 21 Md. 50, 92.

² *Baltimore and Ohio R. R. Co. v. Wheeling*, 13 Gratt. (Va.) 40. See *Thompson v. Erie R'y Co.*, 11 Abb. Pr. N. S. (N. Y.) 188.

³ See *Hersey v. Veazie*, 24 Me. 9; *Cogswell v. Bull*, 39 Cal. 324; *Leo v.*

Union Pac. R'y Co., 19 Fed. Rep. 283. A shareholder may restrain an act which, if done, would be a ground of forfeiture of the charter. *Rendall v. Crystal Palace Co.*, 4 Kay & J. 326.

⁴ 2 Hare, 493, 494.

⁵ See *Railway Co. v. Allerton*, 18 Wall. 233; *Dimpfell v. Ohio, etc. R. Co.*, 110 U. S. 209, § 140.

⁶ Chap. 7, part iii.

narily can prevent the doing of any *ultra vires* act;¹ provided, he is not chargeable with acts or omissions by which his rights can be held waived or forfeited.² Thus, a shareholder in a railroad corporation may enjoin the carrying out of an *ultra vires* lease of the road;³ or the performance of an illegal contract.⁴

A minority or a single shareholder may restrain the corporation, or the corporate management, from diverting the corporate funds to unauthorized purposes.⁵ Accordingly, a shareholder may enjoin a railroad corporation from using its funds or pledging its credit in order to extend its road beyond the termini designated by the charter;⁶ or from purchasing, without authority to do so, stock in another railroad company.⁷ And a company, incorporated to manufacture pig iron, may be enjoined by one of its shareholders from erecting a corn and flour mill.⁸

§ 557. Unless the right to alter and repeal is reserved to the state,⁹ or some express provision in the original constituting instrument covers the matter, the charter or the articles of association cannot, against the will of a single shareholder, be substantially altered by the legislature,¹⁰ even with the consent of the majority.¹¹ And a shareholder has his remedy by injunction to

When shareholders may enjoin the acceptance of an amendment.

¹ *Natusch v. Irving, Gow on Part.*, road Co., 24 Pa. St. 378; *Cumberland ed. 3*, App. 576; *Const v. Harris*, Valley R. R. Co.'s Appeal, 62 Pa. St. Turn. & R. 496; *Gifford v. New Jersey R. R. Co.*, 10 N. J. Eq. 171; 218; *Charlton v. Newcastle, etc. R'y Co.*, 5 Jur. N. S. 1096.
² *Dodge v. Woolsey*, 18 How. 331; *Stewart v. Erie, etc. Trans. Co.*, 17 Minn. 372, 398. See *Angell and Ames on Corp.*, § 398; *Coleman v. Eastern Counties R'y Co.*, 10 Beav. 1; *March v. Eastern R. R. Co.*, 40 N. H. 548.

³ See *Dimpfell v. Ohio, etc. R. Co.*, 110 U. S. 209; *Cozart v. Georgia R. R., etc. Co.*, 54 Ga. 379; *Gray v. Chaplin*, 2 Russ. 126; *Graham v. Birkenhead R'y Co.*, 2 Mac. & G. 146.

⁴ *Board, etc. Tippecanoe County v. Lafayette, etc., R. R. Co.*, 50 Ind. 85; *Mills v. Central R. R. Co.*, 41 N. J. Eq. 1.

⁵ *Morrill v. Boston and Maine R. R.*, 55 N. H. 531; *Sandford v. Rail-*

road Co., 24 Pa. St. 378; *Cumberland Valley R. R. Co.'s Appeal*, 62 Pa. St. 218; *Charlton v. Newcastle, etc. R'y Co.*, 5 Jur. N. S. 1096.

⁶ *March v. Railroad*, 43 N. H. 515; *Simpson v. Westminster Palace Hotel Co.*, 8 H. L. Cas. 712; *Lyde v. Eastern Bengal R'y Co.*, 36 Beav. 10.

⁷ *Stevens v. Rutland, etc. R. R. Co.*, 29 Vt. 545. Compare *Durfee v. Old Colony, etc. R. R. Co.*, ante, § 534.

⁸ *Cherokee Iron Co. v. Jones*, 52 Ga. 276.

⁹ See §§ 523, 534.

¹⁰ See §§ 450 *et seq.*

¹¹ *New Orleans, etc. R. R. Co. v. Harris*, 27 Miss. 517; *Black v. Dela-*

restrain the acceptance of a radical amendment.¹ Accordingly, in a case where a person subscribed for shares in the stock of a railroad corporation, which afterwards, by a vote of a majority of shareholders, accepted legislation transferring all its franchises and rights to another corporation, the legislation and the transfer depending on it were alike held void, and the latter corporation failed to enforce the subscription.² But the legislature may confer on the corporation such additional powers as tend to facilitate the accomplishment of the original purposes of incorporation; and acts done in pursuance of such powers will ordinarily be binding, unless they conflict with vested rights or impair the obligation of some contract.³

§ 558. It is the duty of the corporate management to conduct the affairs of the corporation in the interests of the shareholders as such;⁴ and the management is not justified in promoting the outside interests of a majority of shareholders in disregard of the interests in the corporate enterprise of never so small a minority. A court will interfere at the suit of a minority when the majority seek to appropriate the assets of the company, or to obtain for themselves advantages not shared by the minority.⁵

Corporate affairs must be managed in interests of the shareholders as such.

ware and Raritan Canal Co., 24 N. J. Eq. 455; *Mowrey v. Indianapolis, etc. R. R. Co.*, 4 Biss. 78. See *Hope Mut. Fire Ins. Co. v. Beckmann*, 47 Mo. 93, 97.

¹ *Mowrey v. Indianapolis, etc. R. R. Co.*, 4 Biss. 78. But he must be guilty of no laches. *Chapman v. Mad River and L. E. R. R. Co.*, 6 O. St. 119.

² *New Orleans, etc. R. R. Co. v. Harris*, 27 Miss. 517.

³ *Gifford v. New Jersey R. R. Co.*, 10 N. J. Eq. 171. See § 227. *Mower v. Staples*, 32 Minn. 284, holds that a majority of shareholders can accept an amendment to the charter increasing the number of directors from five to nine. In this case the charter was

subject to alteration and amendment, see *Laws of Minn. 1851*, p. 22.

It has been held that shareholders may be bound by provisions not actually found in the charter, when the charter authorizes the directors to make by-laws, not contrary to the law of the land, for the general administration of the corporate affairs. *Union Bank v. Guice*, 2 La. Ann. 249.

⁴ Compare *Baltimore and Ohio R. R. Co. v. Wheeling*, 13 Gratt. (Va.) 40.

⁵ *Menier v. Hooper's Telegraph Works*, L. R. 9 Ch. 350. See *Jones v. Morrison*, 31 Minn. 140; *Ervin v. Oregon R'y, etc. Co.*, 23 Blatchf. 517. A complaint alleged that the officers of a corporation were members of one

§ 559. In the case of *Goodin v. Cincinnati, etc. Canal Co.*,¹ a railroad company, having purchased a majority of the stock of a canal company, elected for the latter a board of directors in their own interest; and then with the assent of such board appropriated the entire property, including the canal, of the canal company as a railroad track, paying a price agreed on between the directors of the two companies, which was far below the value of the property. It was held that the shareholders and creditors of the canal company could not, after the road had been completed, reclaim the property or enjoin its use; but could compel the railroad company to pay them the difference between the value of the property and the price which the railroad company paid for it.

Justice Welsh said, giving the opinion of the court: "To undertake by getting control of the company, and then, under pretence of acting as agents and trustees for all the stockholders and creditors, deliberately to trample under foot the rights of the minority, is rather a sharp practice, and one which a court of equity will never tolerate. A director whose personal interests are adverse to those of the corporation, has no right to act as a director. As soon as he finds that he has interests in conflict with those of the company, he ought to resign, no matter if a

family, owned a majority of the stock, had combined to appropriate the profits of the corporation in the shape of salaries, and, through a contract with a firm in which some of the officers were partners, had obliged the corporation to take all its contracts in the firm's name; that the plaintiff did not know the terms of this contract, and was excluded from inspecting the corporate books, and that, though the profits were large, the dividends were small. The complaint was held to have stated a sufficient ground for equitable relief. *Sellers v. Phoenix Iron Co.*, 13 Fed. Rep. 20. See also *Jones v. Morrison*, 31 Minn. 140; and §§ 608, 609. Compare *Metropolitan Elevated R. R. Co. v. Manhattan Elevated R. R. Co.*, 11 Daly (N. Y.), 373, 516.

In dealing with the relations between the corporation and its officers on the one hand, and shareholders on the other, courts of equity will look beyond the mere observance of the forms of law. At the instance of shareholders they will restrain acts even within the scope of corporate powers, if such acts, when done, would, under the particular circumstances, amount to a breach of the very trust upon which the authority was conferred. And a court will relieve an injured shareholder even after the act is done, unless the superior equities of innocent persons have, in the meanwhile, attached. *Wright v. Oroville M'g Co.*, 40 Cal. 20.

¹ 18 O. St. 169.

majority of stockholders, as well as himself, have personal interests in conflict with the company. He does not represent them as persons, or represent their personal interest. He represents them as stockholders, and their interests as such. He is trustee for the company, and whenever he acts against its interests—no matter how much he thereby benefits foreign interests of the individual stockholders, or how many of the individual stockholders act with him—he is guilty of a breach of trust, and a court of equity will set his acts aside, at the instance of stockholders or creditors who are damnified thereby. Any act of the directors by which they intentionally diminish the value of stock or property of the company is a breach of trust, for which any of the stockholders or creditors may justly complain although all the other stockholders and creditors are benefited in some other way more than they are injured as such.”¹

§ 560. A minority of shareholders, on behalf of themselves and other shareholders, may, for conspiracy and fraud, whereby their interests have been sacrificed, maintain a bill in equity against the corporation, its officers, and others who have participated in the wrongful acts.² But a bill in equity brought by shareholders against the corporation, and persons who were its directors in former years, for fraud and conspiracy whereby the interests of the corporation had been sacrificed, cannot be maintained unless the bill show either that an effort has been made by an application to the directors in office at the time of bringing the bill to set the corporation in motion to redress the wrong, or that such application would have been useless. And this requirement is not satisfied by an allegation that a majority of directors are acting in the interests and under the control of persons charged with the fraud.³ A formal application and refusal need not be alleged, however, if enough appear to show that such an application would be unavailing. And allegations that individual defendants control the majority of the stock and the

¹ *Goodin v. Cincinnati, etc. Canal Co.*, 18 Ohio St. 169, 182. See *State v. Brown*, 64 Md. 199, 206. See *ib.* Unless by unreasonable delay they forfeit their right to equitable relief.

§§ 627 *et seq.*

³ Cases in next note.

² *Peabody v. Flint*, 6 Allen, 52.

proceedings at the corporate meetings, and that a majority of the directors are knowingly and fraudulently colluding with them to continue to them the control of the corporation and its property, sufficiently show that no redress can be obtained through the corporation or its directors.¹

§ 561. A shareholder, in matters outside of his relationship as such, has the same capacity to sue the corporation as any other person having a right of action against it.² Thus a shareholder, who is also an officer, may sue the corporation for injuries caused by the negligence of the corporation in allowing a ditch belonging to it to break and overflow his lands; he having often protested against the mode in which the ditch was constructed, and having offered to reconstruct it himself, which the corporation would not permit.³

Like outsiders, a shareholder may sue the corporation.

§ 562. From what has preceded it appears that, as long as the corporation carries on its business, the general right of individual shareholders in the corporate funds is to have them applied to the purposes of incorporation in a reasonable and proper manner, so that, due regard being had to the continuing solvency of the corporation, profits may accrue. When profits have arisen from corporate transactions, shareholders have no unconditional right to their immediate distribution as dividends.⁴ For it ordinarily lies within the discretion of the corporate management to decide whether profits shall be distributed

Shareholders have no unconditional right to a division of profits.

¹ *Brewer v. Boston Theatre*, 104 Mass 378; *Rogers v. Lafayette Agricultural Works*, 52 Ind. 296; *Pond v. Vermont Valley R. R. Co.*, 12 Blatchf. 280. See *Heath v. Erie R'y Co.*, 8 Blatchf. 347. See also §§ 686-691. Compare *Cannon v. Trask*, L. R. 20 Eq. 669; *Merchants and Planters' Line v. Waganer*, 71 Ala. 581.

² *Bripham v. Wellersburg Coal Co.*, 47 Pa. St. 43; *Life Association v. Levy*, 33 La. Ann. 1203; *Barker v. Cairo, etc. R. R. Co.*, 3 T. & C. (N. Y.) 328. See *Criswell's Appeal*, 100 Pa. St. 488.

³ *Burbank v. West Walker River Ditch Co.*, 13 Nev. 431. See also *O'Conner v. North Truckee Ditch Co.*, 17 Nev. 245.

⁴ *Phelps v. Farmers and Mechanics' Bk.*, 26 Conn. 269; *Goodwin v. Hardy*, 57 Me. 145; *Minot v. Paine*, 99 Mass. 101. See *Gordon v. Richmond, etc. R. R. Co.*, 78 Va. 501, 518. An unconditional agreement to pay a shareholder a specified dividend each year is *ultra vires*, and cannot be enforced against the corporation. *Elevator Co. v. Memphis, etc. R. R. Co.*, 85 Tenn. 703.

among the shareholders, or whether they shall be applied to the payment of the debts of the corporation or be retained as a surplus fund.¹ Should the question arise of applying the profits to a substantial extension of the corporate business, its decision would probably rest with the body corporate; and if the extension is within the powers of that body, and a majority in a duly summoned meeting decide in favor thereof, the minority cannot prevent the application of the corporate funds thereto.²

§ 563. A court of equity, however, may interfere when there is a palpably wrongful refusal to declare a dividend;³ especially when a certain percentage of dividends is promised or guaranteed on certain shares. "While, as a general rule, courts of equity will not exercise visitatorial powers over a corporation, and its officers are the sole judges of the propriety of declaring dividends, and in this respect the court will not interfere with a proper exercise of their discretion, yet where the right to the dividend is clear and fixed by the contract, and requires the directors to take action before it can be asserted in a court of law,⁴ and a restraint by injunction is essential to maintain the right of the stockholder, the injunction of a court of equity is a proper exercise of its power, and should be upheld."⁵ In general it may

But courts will sometimes interfere, especially in favor of preferred shareholders.

¹ *Ely v. Sprague*, Clarke, Ch. (N. Y.) 351; *State of Louisiana v. Bank of Louisiana*, 6 La. 746; see *Pratt v. Pratt*, 33 Conn. 446; *Karnes v. Rochester, etc. R. R. Co.*, 4 Abb. Pr. N. S. (N. Y.) 107; *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. (N. Y.) 280, 303; *Smith v. Prattville M'fg Co.*, 29 Ala. 503; *Howell v. Chicago and N. W. R'y Co.*, 51 Barb. 378.

² See *Durfee v. Old Colony, etc. R. R. Co.*, ante, § 534.

³ *Scott v. Eagle Fire Co.*, 7 Paige (N. Y.), 198, 203. See *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *Browne v. Monmouthshire R'y Co.*, 13 Beav. 32.

If the body corporate by vote instructs the directors to pay a dividend at some future day specified, if the

corporation shall then have sufficient funds applicable to the payment of dividends, though a court will give due weight to the decision of the directors on the point of the corporation's ability to pay the dividend, the court will not treat that decision as conclusive. *Barnard v. Vermont, etc. R. R. Co.*, 7 Allen, 512; *Richardson v. Railroad Co.*, 44 Vt. 613.

⁴ In general, a shareholder cannot sustain an action for a dividend without proof of a making of the dividend and a demand of payment. *Scott v. Central R. R., etc. Co.*, 52 Barb. 45.

⁵ *Boardman v. Lake Shore, etc. R'y Co.*, 84 N. Y. 157, 180. See *Park v. Grant Locomotive Works*, 40 N. J. Eq. 114.

be said, with regard to the payment of dividends on preferred shares, that the decision of the directors is not conclusive; and if the corporation has funds applicable to the payment of dividends, preferred shareholders may compel a payment in accordance with the terms on which the preferred shares were issued.¹

§ 564. That dividends on preferred shares are "guaranteed," authorizes the interpretation that they are cumulative; and the arrears must be paid before any dividend can rightfully be paid on the common stock.²

Preferred
dividends
cumulative.

§ 565. Rightfully, dividends can only be paid out of profits; and the distribution in dividends of the capital of the corpora-

¹ *Boardman v. Lake Shore, etc. R'y Co.*, 84 N. Y. 157; *West Chester, etc. R. R. Co. v. Jackson*, 77 Pa. St. 321; *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491; *Nickals v. New York, L. E. & W. R. Co.*, 15 Fed. Rep. 575; see *St. John v. Erie R. R. Co.*, 22 Wall. 136; compare *Williston v. Michigan Southern, etc. R. R. Co.*, 13 Allen, 400; *Belfast and M. L. R. Co. v. Belfast*, 77 Me. 445.

The holders of common stock are not necessary parties to an action by preferred shareholders to compel the payment of dividends claimed to be due the latter. *Thompson v. Erie R. R. Co.*, 45 N. Y. 468.

It has been held, however, that an agreement between two corporations whereby one guarantees to the other a certain specified annual dividend on its capital stock, is not a guaranty to the shareholders individually, but only to the corporation; that the respective boards of directors have power to modify such an agreement; and that a court of equity will not interfere if that power is fairly exercised. *Flagg v. Manhattan R'y Co.*, 10 Fed. Rep. 413; S. C., 20 Blatchf. 142 and 21 Am. Law Reg. N. S. 775; *People v.*

Metropolitan Ry. Co., 26 Hun, 82. See *Sheffield Nickel Plated Co. v. Unwin*, 36 L. T. N. S. 246; S. C., L. R. 2 Q. B. Div. 214.

² *Boardman v. Lake Shore, etc. R'y Co.*, 84 N. Y. 157; *Westchester, etc. R. R. Co. v. Jackson*, 77 Pa. St. 321; *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491; *Prouty v. Michigan Southern, etc. R. R. Co.*, 1 Hun, 665. Compare *Williston v. Same*, 13 Allen, 400; *New York, L. E. and W. R. R. Co. v. Nickals*, 119 U. S. 296.

The right of preferred shareholders is substantially a right to interest at the stipulated rate chargeable exclusively on profits, and payable, with arrears, before anything be divided among ordinary shareholders. *Henry v. Great Northern R'y Co.*, 3 Jur. N. S. 1133. But it may be provided expressly that the dividends on preferred shares are not to be cumulative. See *Bailey v. Railroad Co.*, 17 Wall. 96. Or this may be inferred from the language of the by-law providing for the dividends on the preferred shares. *Belfast and M. L. R. R. Co. v. Belfast*, 77 Me. 445. For the respective rights of preferred and common shareholders on dissolution, see § 786.

tion may be enjoined by a shareholder.¹ "Net earnings," said Judge Blatchford, with reference to a railroad company, "are, properly, the gross receipts, less the expenses of operating the road to earn such receipts. Interest on debts is paid out of what thus remains, that is, out of net earnings. Many other liabilities are paid out of net earnings. When all the liabilities are paid, either out of gross receipts or out of the net earnings, the remainder is the profit of the shareholders, to go towards dividends, which in that way are paid out of the net earnings."² Even a holder of "preferred

¹ *Carpenter v. New York and N. H. R'y Co.*, 5 Abb. Pr. (N. Y.) 277; *Macdougall v. Jersey Imperial Hotel Co.*, 2 Hem. and M. 528; *Bloxam v. Metropolitan R'y Co.*, L. R. 3 Ch. 337. See *Fawcett v. Laurie*, 1 Dr. and Sm. 192; *Carlisle v. South Eastern R'y Co.*, 1 Mac N. and G. 689; *Browne v. Monmouthshire R'y Co.*, 13 Beav. 32; *Coates v. Nottingham Waterworks Co.*, 30 Beav. 86. "By loss or misfortune or misconduct of the managing officers of a corporation, its capital stock may be reduced below the amount limited by its charter; but whatever property it has up to that limit must be regarded as its capital stock. When its property exceeds that limit, then the excess is surplus. Such surplus belongs to the corporation, and is a portion of its property, and, in a general sense, may be regarded as a portion of its capital, but in a strictly legal sense, it is not a portion of its capital, and is always regarded as surplus profits. . . . The surplus may be in cash, and then it may be divided in cash; it may be in property, and if the property is so situated that a division thereof among the stockholders is practicable, a dividend in property may be declared, and that may be distributed among stock-

holders." *Williams v. Western Union Tel. Co.*, 93 N. Y. 162, 188.

² *St. John v. Erie R'y Co.*, 10 Blatchf. 271, 279; S. C., 22 Wall. 136. It does not necessarily follow that all debts of a floating character should be paid before a dividend is declared; only such need be paid as good judgment requires under the circumstances. *Belfast and M. L. R. R. Co. v. Belfast*, 77 Me. 445. See also as to payment of dividends when the corporation is indebted, *Mills v. Northern R'y Co.*, L. R. 5 Ch. 631. In estimating profits for purposes of Federal taxation, earnings are not to be included, unless they represent profits of the company in its business as a whole, *i. e.*, the excess of the aggregate of gains from all sources over the aggregate of losses. The burden of proof is on the United States to show what is due. *Little Miami, etc. R. R. Co. v. United States*, 108 U. S. 277. "As a general proposition, net earnings are the excess of the gross earnings over expenditures defrayed in producing them, aside from and exclusive of the expenditure of capital laid out in constructing and equipping the works themselves." *Union Pacific R. R. Co. v. United States*, 99 U. S. 402, 420; opinion of the court per Bradley,

and guaranteed" stock is entitled to be paid his guaranteed percentage only out of the profits of the corporation legally applicable to the payment of dividends.¹ He is not a creditor, it being really a dividend and not a debt that is guaranteed.² Thus, in a recent case in the Federal Supreme Court, preferred shares had been issued with certificates in the following form: "The preferred stock is to be and remain a first claim upon the property of the corporation after its indebtedness, and the holder thereof shall be entitled to receive from net earnings of the company seven per cent. per annum, payable semi-annually, and to have such *interest* paid in full in each and every year before

J. See also *Sioux City and P. R. R. Co. v. United States*, 110 U. S. 205. See also regarding what constitutes "net earnings," *Union Pac. R. R. Co. v. United States*, 99 U. S. 402; *United States v. Central Pac. R. R. Co.*, ib. 449; *Same v. Kansas Pac. R'y Co.*, ib. 455.

¹ *St. John v. Erie Railway Co.*, *supra*. *Taft v. Hartford, etc. R. R. Co.*, 8 R. I. 310; *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110. Compare *Gordon v. Richmond, F. and P. R. R. Co.*, 78 Va. 501, 517. A contract by the corporation to pay annual dividends to preferred shareholders, without reference as to whether there are earnings (*i. e.*, an implied agreement to pay dividends, although there are no profits), is opposed to public policy and void. *Lockhart v. Van Alstyne*, 31 Mich. 76. See *Elevator Co. v. Memphis, etc. R. R. Co.*, 85 Tenn. 703. But the terms on which "preferred shareholders" receive their interest may be such that courts will regard them as creditors; *e. g.*, when they have no right to vote, and four per cent. annually is guaranteed them, with repayment of the principal at a time specified, and a mortgage is executed to secure them. *Burt v. Rattle*, 31 Ohio St. 116; see *Totten v. Tison*,

54 Ga. 139. Compare *West Chester, etc. R. R. Co. v. Jackson*, 77 Pa. St. 321; *Williston v. Michigan Southern, etc. R. R. Co.*, 13 Allen, 400. In a late Massachusetts case, a statute authorizing a corporation to issue "preferred stock" provided: (1) "the said company to give its guaranty that each share of said stock shall receive semi-annual dividends of four dollars on each share; provided, that no share of such preferred stock shall be issued until the said company shall receive one hundred dollars therefor." (2) No dividends more than four dollars per share semi-annually to be paid on said stock under any circumstances, but any holder may exchange for common stock share for share. (3) "In case of dissolution . . . the holders of preferred stock shall be entitled to payment of the same in full next after payment of the debts of the company, and before any payments to the holders of stock not preferred." *Held*, that the guaranty of dividends was *not* conditional on the earning of profits. *Williams v. Parker*, 136 Mass. 204.

² *Taft v. Hartford, etc. R. R. Co.*, 8 R. I. 310; *Branch v. Jesup*, 106 U. S. 468; *Belfast and M. L. R. R. Co. v. Belfast*, 77 Me. 445. Compare preceding note.

any payment of dividend upon the common stock." The holders of these shares were held to be merely shareholders, and entitled to no lien on the property of the corporation prior to the lien of the corporate indebtedness contracted after their issue; but were entitled only to a priority over the common shares.¹

§ 566. If a dividend has been paid from funds of the corporation other than those out of which dividends may legally be paid, the corporation may recover it back. Thus an insurance corporation is not justifiable in treating premiums received upon unexpired risks as profits subject to division when it has no independent fund sufficient to meet all liabilities that may accrue on pending risks. And dividends paid from such a source may be reclaimed by the corporation.²

Recovery of
dividends
illegally
paid.

§ 567. A share has been defined as "a right to partake, according to the amount of the party's subscription, of the surplus profits obtained from the use and disposal of the capital stock of the company to those purposes for which the company is constituted."³ It is to be noted that

¹ Warren v. King, 108 U. S. 389.

² Lexington Life, etc. Ins. Co. v. Page, 17 B. Mon. (Ky.) 412. The statute of limitations runs in favor of shareholders *bona fide* receiving such dividends, from the time they were declared, as against the corporation and its creditors. *Ib.* Compare, also, Scott v. Eagle Fire Co., 7 Paige, 198; De Peyster v. American Fire Ins. Co., 6 Paige, 486; see also § 708.

³ Angell and Ames on Corp., § 557.

"The capital stock is that money or property which is put into a single corporate fund, by those who by subscription therefor become members of the corporate body. That fund becomes the property of the aggregate body only. A share of the capital stock is the right to partake according to the amount put into the fund of the surplus profits of the corporation, and ultimately on the dissolution of it, of

so much of the fund thus created as remains unimpaired, and is not liable for the debts of the corporation." Burrall v. Bushwick R. R. Co., 75 N. Y. 211, 216. Compare State v. Morristown Fire Ass'n, 23 N. J. L. 195; Williams v. Western Union Tel. Co., 93 N. Y. 162, 188.

An attachment of shares does not encumber the property of the company or prevent the company from assigning it. Gottfried v. Miller, 104 U. S. 521. Compare Van Norman v. Jackson Circuit Judge, 45 Mich. 204. A shareholder has no interest in real estate owned by his corporation that will entitle him to a vendor's lien thereon as against a company formed by the consolidation of his company with another. Cross v. B. and S. W. R. Co., 58 Iowa, 62.

Shares are not "securities." Campbell v. Morgan, 4 Ill. App. 100; Ogle

a share is called a right to partake in profits "obtained from the use and disposal of the capital stock . . . to those purposes for which the company is constituted." Should the capital be employed for unauthorized purposes the shareholders might not be absolutely entitled to the profits arising from such use even after they had been declared in the form of a dividend, but circumstances are conceivable under which the shareholders might, at least to the extent of dividends received by them, be called on to meet any liability subsequently arising from the improper employment of the capital. And those directors or shareholders who had actively participated in the improper acts might possibly be held liable personally to persons injured thereby.

§ 568. After a dividend has been declared each shareholder has as against the corporation an unconditional right to his portion of it;¹ but cannot sue the corporation for it without a previous demand.² The discretion of the corporate management is exhausted in declaring the dividend; thereupon their only function is to pay it to the shareholders. But it has been held that when a corporation has voted to issue further stock out of surplus profits—in effect to declare a stock dividend³—but has taken no further steps to file a certificate of the increase or to issue certificates of stock, a shareholder who stands by for a year until many shares have changed hands cannot compel the issue to him of his proportionate number of shares.⁴ It appeared in this case that the increase had been voted for a special purpose which had become impracticable. The complainant argued that a stock dividend was like a cash dividend, and that he acquired

Rights of shareholders after a dividend has been declared.

v. Knipe, L. R. 8 Eq. 434; *Collins v. Collins*, L. R. 12 Eq. 455; *Hudleston v. Gouldsbury*, 10 Beav. 547. Shares are choses in action. *Keyser v. Hitz*, 2 Mackey (Dist. of Col.), 473.

¹ *Beers v. Bridgeport Spring Co.*, 42 Conn. 17; *King v. Paterson*, etc. R. R. Co., 29 N. J. L. 82. See *Matter of Le Blanc*, 14 Hun, 8; *aff'd* 75 N. Y. 598.

² *State v. Baltimore and O. R. R. Co.*, 6 Gill (Md.), 363.

³ A corporation having earned a dividend, and having power to increase its capital stock, may make a stock dividend. *Howell v. Chicago and N. W. R'y Co.*, 51 Barb. 378; *Williams v. Western Union Tel. Co.*, 93 N. Y. 162.

⁴ *Terry v. Eagle Lock Co.*, 47 Conn. 141.

a vested right to it from the moment of the vote. But the court said :¹ "There is a difference between a cash and a stock dividend. The former is created by a simple vote of the directors, and the amount thereby becomes severed from the general fund and belongs to the stockholders *pro rata*. The latter can be initiated only by a vote of the stockholders. That is followed by issuing the stock, and the increase can only be completed legally by filing with the town clerk and with the secretary of state the certificates required by law. . . . Again, a cash dividend entitles the stockholder to so much money, the ordinary way in which he receives from time to time the fruits of his investment. Such dividends do not materially affect the value of the stock. A stock dividend is exceptional. It does not add to his ready cash, but changes the form of his investment by increasing the number of shares, thereby diminishing the value of each share, leaving the aggregate value of his stock substantially the same. It is of no special importance whether that value be divided into a few or many shares."²

§ 569. The power of a corporation to purchase its own shares or increase or decrease its capital stock has already been discussed.³ If the capital stock is increased by the proper authorities, the right to take the additional shares vests in the shareholders *pro rata*. This right may be waived ; but the directors cannot deprive a shareholder of it,⁴ nor burden it with conditions unauthorized by the charter or enabling act, as for instance, the payment of so much per share for the privilege of subscribing.⁵

Right to
subscribe
to additional
shares on
an increase
of the capital
stock.

¹ 47 Conn. 164.

² Still the decision of this case seems really to have turned on the plaintiff's own laches.

³ § 133.

⁴ *Eidman v. Bowman*, 58 Ill. 444 ; *Hart v. St. Charles St. R. R. Co.*, 30 La. Ann. Pt. I. 758 ; *Jones v. Morrison*, 31 Minn. 140. In the last case the stock of a corporation was all held by a few holders, the plaintiff owning about one-third of it. While he was absent in Europe, a vote was passed

(as was competent) to increase the stock, which was worth much more than par, and to allow the old shareholders to subscribe in proportion to their shares. This privilege was limited in time to a shorter period than was possible for the plaintiff to act in the matter, as the rest knew. It was held that he had a right to subscribe after such period had expired.

⁵ *Cunningham's Appeal*, 108 Pa. St. 546.

Accordingly, when a corporation is issuing new stock generally and refuses to issue to a shareholder his due proportion, he can compel it to do so by a suit in equity; at least so long as there remains stock undisposed of.¹ And when new stock is issued to share equally with the existing stock, it is the right of each shareholder that it shall be so distributed as not to divest him of his vested proportionate right in the corporate property, including the accumulated profits.² But this rule is held not to apply to old stock purchased by the company, on which the right to vote is merely suspended. Such stock directors in their discretion may reissue or sell for the benefit of the corporation.³ A corporation having the power to issue further stock, may issue it in exchange for an equal amount of its indebtedness; and no particular form of subscription is necessary.⁴

When the officers of a corporation decide upon an increase of its stock, and give notice thereof to the shareholders, such shareholders as subscribe and pay their subscriptions may maintain an action to recover them, if the corporation fails to fulfil the conditions of the subscription contract.⁵

§ 570. Conversely, when a national bank under the United States Revised Statutes, § 5143, reduces the amount of its capital stock, it must return to the shareholders *pro rata* the amount of capital set free, and cannot retain a portion of it for a surplus.⁶ When a corporation competently reduces the amount of its capital stock, a shareholder

Rights on a decrease of stock.

¹ Dousman v. Wisconsin, etc. M'g Co., 40 Wis. 418. It seems, also, that the shareholder could have maintained an action for damages against the corporation. *Ib.*

When a corporation has issued the full number of shares authorized, no court can compel it to issue further shares unless some of the shares originally issued were void. *Smith v. North Am. M'g Co.*, 1 Nev. 423. See § 541.

² *State v. Smith*, 48 Vt. 266; *Gray v. Portland Bank*, 3 Mass. 364.

³ *State v. Smith*, 48 Vt. 266. See

State Bank v. Fox, 3 Blatchf. 431; *Williams v. Savage M'fg Co.*, 3 Md. Ch. 418.

⁴ *Lohman v. New York and Erie R. R. Co.*, 2 Sandf. (N. Y.) 39. See cases in last note.

⁵ *Eaton v. Pacific National Bank*, 144 Mass. 260. Provided, of course, that the shareholder suing for his money has done nothing to estop himself, and no right of creditors of the corporation intervene.

⁶ *Seely v. New York Nat. Exch. Bk.*, 8 Daly, 400; *S. C.*, 4 Abb. N. C. (N. Y.) 61.

cannot restrain the division among the shareholders of the surplus over and above the amount to which the stock is reduced, provided that amount exceeds the liabilities of the company; even though the statute authorizing the reduction makes no provision for such division.¹

§ 571. Whether, when not specially authorized, a corporation on the first issue of its stock may divide the same into classes, and issue a portion as preferred stock, is not altogether settled by authority. There seems to be no decision in this country, however, forbidding a corporation to issue preferred shares provided it keep within the limits of the stock which it is authorized to issue, and does not in any way impair the vested rights of any shareholder.² And it has been held that where it appears necessary to raise further capital and to issue preferred shares, the legislature may authorize the issue on a vote of the holders of common shares, and a dissenting shareholder cannot prevent the issue of preferred shares nor the payment of dividends thereon.³ Nevertheless, unless the right to alter and repeal is reserved to the legislature, it would seem that no constitutional legislation could authorize the issue of preferred shares when such an issue would impair the rights of any shareholder in the corporate funds.

§ 572. A leading case on the power of a corporation to issue preferred shares is *Kent v. Quicksilver Mining Co.*;⁴ a case in which a number of appeals, taken in actions brought to determine the validity of certain preferred shares, were heard together before the New York Court of Appeals. The following somewhat extended citation is from the opinion of that court delivered by Judge Folger: "We know nothing in the

¹ *Strang v. Brooklyn Cross-town R. R. Co.*, 93 N. Y. 426. As to the division of surplus assets of a mutual insurance company, see *Carlton v. Southern Mutual Ins. Co.*, 72 Ga. 371.

² *Hazelhurst v. Savannah, etc. R. R. Co.*, 43 Ga. 13. See for what was held authority to issue preferred shares, *Gordon v. Richmond, etc. R. R. Co.*, 78 Va. 501.

³ *City of Covington v. Covington, etc. Bridge Co.*, 10 Bush (Ky.), 69. This on the principle that such amendments to the charter may be made by the legislature as are necessary to enable the original enterprise to be carried out. *Ib.* See also *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536.

⁴ 78 N. Y. 159.

Constitution or the law that inhibits a corporation from beginning its corporate action by classifying the shares in its capital stock with peculiar privileges to one share over another, and thus offering its stock to the public for subscription thereto. No rights are got until a subscription is made. Each subscriber would know for what class of stock he put down his name, and what right he got when he thus became a stockholder. There need be no deception or mistake; there would be no trenching upon rights previously acquired: no contract, express or implied, would be broken or impaired.

“This corporation did otherwise. A by-law was duly made, which declared the whole value of its property and the whole amount of its capital stock, and divided the whole of it into shares equal in amount, and directed the issuing of certificates of stock therefor. It is not to be said that this by-law authorized anything but shares equal in value and in right; or that the taker of one did not own as large an interest in the corporation, its capital, affairs, and profits to come, as any other holder of a share. Certificates of stock were issued under this by-law, that gave no expression of anything different from that. When that by-law was adopted, it was as much the law of the corporation as if its provisions had been a part of the charter. (*Presbyterian Church v. City of New York*, 5 Cow. 538.) So it is said in *Grant on Corporations*, page 80, in a qualified way. Thereby, and by the certificate, as between it and every stockholder, the capital stock of the company was fixed in amount, in the number of shares into which it was divisible, and in the peculiar and relative value of each share. The by-law entered into the compact between the corporation and every taker of a share; it was in the nature of a contract between them. The holding and owning of a share gave a right which could not be divested without the assent of the holder and owner; or unless the power so to do had been reserved in some way. (*Mech. Bank v. N. Y. and N. H. R. R. Co.*, 13 N. Y. 599–627.) Shares of stock are in the nature of *choses in action*, and give the holder a fixed right in the division of the profits or earnings of a company so long as it exists, and of its effects when it is dissolved. That right is as inviolable as is any in property, and can no more be taken away or lessened against the will of the

owner than can any other right, unless power is reserved in the first instance, when it enters into the constitution of the right; or is properly derived afterwards from a superior law giver. The certificate of stock is the muniment of the shareholder's title, and evidence of his right. It expresses the contract between the corporation and his co-stockholders and himself; and that contract cannot, he being unwilling, be taken away from him or changed as to him without his prior dereliction, or under the conditions above stated. Now it is manifest that any action of a corporation which takes hold of the shares of its capital stock already sold and in the hands of lawful owners, and divides them into two classes, one of which is thereby given prior right to a receipt of a fixed sum from the earnings before the other may have any receipt therefrom, and is given an equal share afterwards with the other in what earnings may remain, destroys the equality of the shares, takes away a right which originally existed in it, and materially varies the effect of the certificate of stock.¹

"It is said that when a corporation can lawfully buy property or get money on loan, any known assurance may be exacted and given, which does not fall within the prohibition, express or implied, of some statute (*Curtis v. Leavitt*, 15 N. Y. 66-67); and that is sought to be applied here. But the prohibition to such action as this is found, not, indeed, in a statute commonly so called, but in the constitutional provision which forbids the impairment of vested rights, save for public purposes and on due compensation. The right which a stockholder gets on the

¹ In the absence of authority in its articles of association, a company cannot authorize the directors to issue the unallotted shares as preferred stock, against the wishes of a minority; and a shareholder may enjoin such issue. *Hutton v. Scarborough Cliff Hotel Co. (Limited)*, 4 DeG. J. & S. 672; *Melhado v. Hamilton*, 28 L. T. N. S. 578. Compare *Harrison v. Mexican R'y Co.*, L. R. 19 Eq. 358. Authority to issue an increased amount of preferred stock does not authorize the issue of partly preferred and partly common stock. *Covington, etc. Bridge Co. v. Sargent*, 1 Cin. Sup. Ct. (Ohio), 354. That a corporation has accepted an amendment to its charter, authorizing it to issue preferred shares, besides its common stock, does not release a dissenting subscriber to the common stock from his subscription. *Everhart v. Philadelphia and W. C. R. R. Co.*, 28 Pa. St. 339. *Quære?*

purchase of his share and the issue to him of the certificate therefor is such a vested right.

“It is contended that the power so to do is an incidental and implied power necessary to the use of the other powers of the corporation, and is a legitimate means of raising money and securing the agreed consideration therefor. We have already conceded that it is legitimate to borrow money, and to secure the repayment of it, with a compensation for the use of it. But that is when it is done in such way as to put the burthen upon every share of stock alike, and to enable every share of stock to be relieved therefrom alike, in such way as to preserve the equality of right and privilege and value of the shares, and maintain intact the contract thereto with the stockholder.

“Citations are made to us for the converse of this, but they do not come up—sometimes in their facts, sometimes in their declarations—to the necessity of the proposition. Either it is where the capital is not limited and it is new shares that may be issued with a preference, and where there is express power to borrow on bond and mortgage (2 Redf. on Railways, chap. 33, sec. 4, § 237; *Harrison v. Mex. R. W.*, 12 Eng. Rep. 793), or the amount of the capital has not been reached, and such stock is issued therefrom (*Hazelhurst v. Savannah R. R.*, 43 Ga. 53; *Tottan v. Tison*, 54 id. 139), or there was legislative authority (*Davis v. Proprietors*, 8 Metc. 321; *Rutland R. R. Co. v. Thrall*, 35 Vt. 545), or a restriction to authorized capital, and there was unanimous consent of the stockholders (*Prouty v. M. S. and N. I. R. R.*, 1 Hun, 663; 43 Ga. 53, *supra*), or there was power to redeem, which was a transaction in the nature of a debt (*Westchester, etc. R. R. Co. v. Jackson*, 77 Penn. St. 321), or the opinion was *obiter* (*Bates v. Androscoggin R. R. Co.*, 49 Maine, 491), or it was the case of a subscription for stock with a condition for interest until the corporation was in operation (*Richardson v. Vt. and Mass. R. R. Co.*, 44 Vt. 613), or it was an action on a subscription more favorable to defendant than to other subscribers, and it was held that defendant could not set up the lack of equality (*Evansville R. R. Co. v. Evansville*, 15 Ind. 395), or a solemn determination of this question was not necessary for the disposal of the case (*Williston v. M. S. and N. I. R. R. Co.*, 13 Allen, 400), or the issue was authorized by

the articles of association (*In re A. D. St. Nav. and Col. Co.*, 20 L. R. [Eq.] 339), or there was full knowledge on the part of all concerned (*Lockhart v. Van Alstyne*, 31 Mich. 81), or the power in the corporate body was conceded, and it was denied that it existed in the directors (*McLaughlin v. D. and M. R. R.*, 8 id. 100). . . . It needs not that we consider the position that the issue of the preferred stock was an authorized increase of the capital and so legal. It did not profess to be, nor was it in fact. For each share of preferred stock given out a share of common stock was taken in, so that the gross amount of the capital was still the same, and so were the number of shares and the nominal value of each share.”¹

§ 573. Each shareholder has a right to have the corporate funds managed and applied *in the manner* prescribed by the constitution of the corporation. It is his right that the directors shall act regularly by a proper quorum:² that corporate meetings shall be summoned and shall act regularly;³ and that he shall receive due notice of them.⁴ “It is not only a plain dictate of reason but a general rule of law, that no power or function entrusted to a body consisting of a number of persons can be legally exercised without notice to all of the members composing such body.”⁵ The notice should specify the time and place of the

Meetings of
the corpo-
ration.
Notice.

¹ *Kent v. Quicksilver Mg. Co.*, 78 N. Y. 159, 179 *et seq.*

It is held that a corporation is not a trustee for preferred any more than for common shareholders, and the former have no special control over the corporation and its management. *Thompson v. Erie R'y Co.*, 11 Abb. Pr. N. S. (N. Y.) 188.

When a company disables itself from issuing preferred stock subscribed for, the subscriber may refuse to take common stock, and may recover his subscription as for a failure of consideration. *Covington, etc. Bridge Co. v. Sargent*, 1 Cin. Sup. Ct. (Ohio) 354.

² See § 184.

³ See *Stow v. Wyse*, 7 Conn. 214;

Stevens v. Eden Meeting-house Soc'y, 12 Vt. 688. Compare *Citizens' Ins. Co. v. Sortwell*, 8 Allen, 217; *Sargent v. Webster*, 13 Metc. (Mass.) 497. At a meeting duly convened a majority may transact business, though a minority of the whole number. *Granger v. Grubb*, 7 Phila. (Pa.) 350.

⁴ *The King v. Theodorick*, 8 East, 543; see *Shortz v. Unangst*, 3 W. & S. (Pa.) 45; *Commonwealth v. Culen*, 13 Pa. St. 133.

⁵ *People v. Batchelor*, 22 N. Y. 128, 134; see *Rex v. Langhorn*, 4 A. & E. 538; *Reilly v. Oglebay*, 25 W. Va. 86.

meeting, the nature of the business to be transacted, and, if the constitution of the corporation contains provisions as to the manner of giving notice, they should be followed.¹

§ 574. The time of the meeting should be stated with precision,² and no business should be transacted before the time set,³ nor after the meeting has apparently adjourned.⁴ A meeting held at a different place from the one notified is irregular;⁵ and the notice should be reasonable in every respect, and, unless otherwise provided, served in person on the shareholders.⁶ The notice of a special or extraordinary meeting should specify the proposed business, and at such a meeting business not referred to in the notice cannot properly be transacted.⁷ But no notice of the business to be transacted at a stated meeting is necessary, unless the business be of an extraordinary nature. Nor need further notice be given of an adjourned meeting where there is transacted only such business as was duly notified for the meeting which was adjourned.⁸ And in general no notice at all need be given of a stated meeting, for which the time and place are set either by usage or by the constitution of the corporation.⁹

¹ *Stockholders, etc. v. Louisville, etc. R. R. Co.*, 12 Bush (Ky.), 62; *Johnston v. Jones*, 23 N. J. Eq. 216; *Stevens v. Eden Meeting-house Soc'y*, 12 Vt. 688; *People's Ins. Co. v. Westcott*, 14 Gray, 440.

² *San Buenaventura M'f'g Co. v. Vassault*, 50 Cal. 534.

³ *People v. Albany, etc. R. R. Co.*, 55 Barb. 344.

⁴ *State v. Bonnell*, 35 Ohio St. 10; see *South School Dist. v. Blakeslee*, 13 Conn. 227; compare *Hardenburgh v. Farmers', etc. Bank*, 2 Green (3 N. J. Eq.), 68.

⁵ *Miller v. English*, 21 N. J. L. 317; *Den v. Pilling*, 24 N. J. L. 653; compare *McDaniels v. Flower Brook M. Co.*, 22 Vt. 274; *Corbett v. Woodward*, 5 Sawyer, 403. Meetings of shareholders cannot be held outside the state. § 382.

⁶ *Stow v. Wyse*, 7 Conn. 214; *Wiggin v. Freewill Baptist Church*, 8 Metc. 301; *Matter of Long Island R. R. Co.*, 19 Wend. 37. See *Tuttle v. Michigan Central Air Line R. R. Co.*, 35 Mich. 247, 252.

⁷ *Atlantic De Laine Co. v. Mason*, 5 R. I. 463; *People's Mut. Ins. Co. v. Westcott*, 14 Gray, 440; *Howbeach Coal Co. v. Teague*, 5 H. & N. 151; *In re Bridport Old Brewery Co.*, L. R. 2 Ch. 191; *In re Silkstone Fall Colliery Co.*, L. R. 1 Ch. D. 38.

⁸ *Warner v. Mower*, 11 Vt. 385.

⁹ *State v. Bonnell*, 35 Ohio St. 10, 15; *People v. Batchelor*, 22 N. Y. 128. Notice of a meeting is immaterial when the party raising the question was present by proxy and voted. *Jones v. Milton, etc. Turnpike Co.*, 7 Ind. 547; see *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381.

§ 575. The meetings must be called by the proper authorities.¹ In business corporations when there is no provision for calling meetings the managing agents may call them.² Generally, however, the charter, articles of association, or by-laws, specify the manner of calling meetings, and such directions should be followed.³ Consequently, the president cannot call a meeting to elect officers when authority to call meetings is vested by the by-laws in the trustees.⁴ But even where from the by-laws other officers have power to call meetings, the managing board has also that power.⁵

Who may
call meet-
ings.

By-laws.
Business
irregularly
transacted.

§ 576. The methods of voting, and of conducting the meetings may be regulated by by-laws,⁶ provided the by-laws are not inconsistent with the terms of the charter or other statutes applicable.⁷ And generally business transacted in disregard of the required form-

¹ Reilly v. Oglebay, 25 W. Va. 36; Congregational Society v. Sperry, 10 Conn. 200. The proper officers may be compelled by *mandamus* to call a meeting. State v. Wright, 10 Nev. 167; People v. Board of Governors, 61 Barb. 397; McNeely v. Woodruff, 13 N. J. L. 352; compare Goulding v. Clark, 34 N. H. 148.

² Stebbins v. Merritt, 10 Cush. 27.

³ See Evans v. Osgood, 18 Me. 213, and § 573.

⁴ State v. Petteinli, 10 Nev. 141.

⁵ Citizens' Mut. Fire Ins. Co. v. Sortwell, 8 Allen, 217. Compare Chamberlain v. Painesville, etc. R. R. Co., 15 Ohio St. 225.

⁶ Commonwealth v. Woelper, 3 S. & R. (Pa.) 29; Juker v. Commonwealth, 20 Pa. St. 484; People v. Crossley, 69 Ill. 195. See Matter of Long Island R. R. Co., 19 Wend. 37.

⁷ When the statute prescribes the mode of electing directors, it cannot be changed by by-law. Brewster v. Hartley, 37 Cal. 15. When the charter provides that annual meetings shall be

held by the shareholders for the election of directors, the directors cannot by a by-law so change the time of holding the annual election that they will continue themselves in office more than a year against the wishes of a holder of a majority of stock. Elkins v. Camden and Atlantic R. R. Co., 36 N. J. Eq. 467. Compare S. C. on Appeal, 37 N. J. Eq. 273, which further holds that directors who are in office cannot dispute the rights of shareholders to obtain a new election, in accordance with the by-laws, and thus prolong their own authority, on the ground that the proposed election is a step towards the illegal and improper control of the property or business of the corporation, and that the complainant stockholder, who holds a majority of the stock, has bought it with the money of rival companies and means to use his rights for purposes detrimental to the corporation. Camden and A. R. R. Co. v. Elkins, 37 N. J. Eq. 273. Compare Ryder v. Alton, etc. R. R. Co., 13 Ill. 516.

alities may be set aside, unless the divergence was trivial, or the rights of outsiders who have acted without notice of the irregularities intervene.¹

§ 577. At corporate meetings every shareholder has a right to vote; and shareholders cannot be deprived of the right, nor can it be changed by legislation unless the charter of the corporation is subject to alteration and repeal.² It is also the right of every shareholder that the elections of corporate officers shall be conducted legally;³ and that only the shareholders shall vote who are rightfully entitled to do so. But an election of officers will not be set aside because illegal votes were admitted, if their rejection would not have changed the result.⁴ Votes cast for an ineligible candidate will

Voting.
Election of
officers.

¹ *People v. Albany, etc. R. R. Co.*, 55 Barb. 344. See § 184.

² Article 16, § 4 of the Pennsylvania Constitution of 1874, permits every shareholder to cast the whole number of his votes for one candidate at an election for directors, or distribute them upon two or more candidates as he may prefer. This provision does not, and could not constitutionally, apply to the charter of a corporation, not subject to alteration and appeal, chartered before 1874, which permitted each shareholder to cast one vote for every share of stock held by him; *i. e.*, one vote for each officer to be elected. *Hays v. Commonwealth*, 82 Pa. St. 518; *State v. Greer*, 78 Mo. 188. But it is held that an amendment accepted by the corporation, changing the voting power of shares, does not release a dissenting subscriber. *Everhart v. Philadelphia and W. C. R. R. Co.*, 28 Pa. St. 339. But directors cannot accept art. 16, § 4 (*supra*), as an amendment to the constitution of their corporation. *Baker's Appeal*, 109 Pa. St. 461.

³ *In re Election of St. Lawrence Steamboat Co.*, 44 N. J. L. 529; *San Buenaventura M'f'g Co. v. Vassault*,

50 Cal. 534; *Matter of Long Island R. Co.*, 19 Wend. 37; *State v. New Orleans, etc. R. R. Co.*, 20 La. Ann. 489.

The appointment of a receiver does not affect the right of shareholders to elect directors. At a meeting to elect directors the right of choosing inspectors is in the shareholders, not in the directors. *State v. Merchant*, 37 Ohio St. 251.

The corporation should be made a party to an application to set aside an election. *Matter of Pioneer Paper Co.*, 36 How. Pr. (N. Y.) 102.

A person who becomes a shareholder after an election, receiving his certificate of stock from a person who took part therein, has no standing in court (under a certain statute) to compel a new election. *In re Application of Syracuse, etc. R. R. Co.*, 91 N. Y. 1.

⁴ *Ex parte Chenango County Mut. Ins. Co.*, 19 Wend. 635; *McNeely v. Woodruff*, 13 N. J. L. (1 Green) 352.

That inspectors were not sworn as prescribed by statute is no ground to set aside an election. *Ex parte Mohawk, etc. R. R. Co.*, 19 Wend. 135; *Ex parte Chenango County Mut. Ins.*

not be thrown away, so as to elect a candidate having a minority of votes, unless the persons casting such votes knew that the person for whom they voted was disqualified.¹ And persons who at an election have a minority only of the votes received by the judges of the election, cannot on a *quo warranto* proceeding brought to oust the improperly elected officers, be declared elected and inducted into office, although it appear that enough legal votes to have given them a majority were offered in their favor and rejected by the judges of election.²

§ 578. The general rule is that the transfer books of the corporation are the evidence as to the persons who are entitled to the rights and privileges of shareholders, including the right to vote.³ And the inspectors of election need not and, perhaps, cannot go behind the transfer books to question the right to vote of one who appears

Co., *supra*. Nor the fact that votes were received, which though legal were not properly proved to be so. *Conant v. Millandon*, 5 La. Ann. 542. Nor that certain persons were excluded from voting by the injunction of a court of competent jurisdiction. *Brown v. Pacific Mail S. S. Co.*, 5 Blatchf. 525.

¹ *In re Election of St. Lawrence Steamboat Co.*, 44 N. J. L. 529; *Jordy v. Hebrard*, 18 La. Ann. 456. See *Reg. v. Mayor of Tewkesbury*, L. R. 3 Q. B. 629. Yet in *Baker's Appeal*, 109 Pa. St. 461, it was held that the court should in determining who were elected disregard votes improperly (cumulatively) cast. At a shareholders' meeting a majority vote of those voting is good, though the vote so cast is not a majority of all the stock. *State v. Chute*, 34 Minn. 135. When seven directors are voted for, yet only five obtain the requisite pluralities (under the cumulative system of voting), their election is valid. *Wright v. Commonwealth*, 109 Pa. St. 560.

² *State v. McDaniel*, 22 O. St. 354.

Persons who take part in the election of officers and the formation of the company, knowing of the non-fulfilment of conditions precedent, cannot afterwards bring *quo warranto* on these grounds against the officers. *Cole v. Dyer*, 29 Ga. 434.

³ *In re Election of St. Lawrence Steamboat Co.*, *supra*; *People v. Robinson*, 64 Cal. 373; *State v. Ferris*, 42 Conn. 560, 568; *Hopkin v. Buffum*, 9 R. I. 513. See *Wilson v. Proprietors*, *ib.* 590. A registered shareholder may vote though he has not paid for his shares. *Savage v. Ball*, 17 N. J. Eq. 142; *Downing v. Potts*, 23 N. J. L. 66. Transferee of shares cannot vote until the transfer is registered. *McNeil v. Tenth Nat. Bk.*, 46 N. Y. 325, 332. An assignment of shares, with power of attorney, executed by a foreign executor, is valid, and the company is bound to record the transfer; it is not necessary that letters testamentary should be taken out here. *Middlebrook v. Merchants' Bank*, 3 Keyes (N. Y.), 135.

by them to be a holder of legally issued stock.¹ But the books are not under all circumstances or for all purposes conclusive as to the right to vote;² nor are they conclusive evidence of the qualification of directors, where a statute requires that directors shall be *bona fide* holders of stock.³ Shares held by the corporation, or in trust for it, cannot be voted on.⁴

§ 579. It is held that shareholders have no implied right to vote by proxy,⁵ but it is competent for a corporation by a by-law to authorize votes to be cast in that manner.⁶ And inspectors cannot reject a vote offered by proxy because the written proxy is not acknowledged. A shareholder must give his agent such written evidence of the agent's right to act as will reasonably assure the inspectors that the agent is acting by the authority of the principal. But the power of attorney need not be in any particular form, or ex-

Voting by proxy.

¹ *In re* Election of St. Lawrence Steamboat Co., *supra*; *Ex parte* Long Island R. R. Co., 19 Wend. 37; *Morrisseaux v. Urquhart*, 19 La. Ann. 482.

A shareholder may vote though he has hypothecated his shares. *Ex parte* Willcox, 7 Cow. (N. Y.) 402; *Ex parte* Barker, 6 Wend. 509. A person may vote on shares standing in his name as trustee. *Ex parte* Barker, *supra*. See *Ex parte* North Shore, etc. Ferry Co., 63 Barb. 556. See also *McHenry v. Jewett*, 90 N. Y. 58; *Johnston v. Jones*, 23 N. J. Eq. 216, 228. An administrator can vote: In the Matter of the North Shore Staten Island Ferry Co., 63 Barb. (N. Y.) 556. A bankrupt may vote on shares standing in his name, with the assent of his assignee in bankruptcy. *State v. Ferris*, 42 Conn. 560.

² *Strong v. Smith*, 15 Hun, 222. A shareholder cannot vote on shares previously assigned, but not transferred on the books of the company, even with the assent and in the presence of the assignee. Commonwealth

v. Woodward, 4 Phila. 124. Compare U. S. R. S., § 5144.

Holders of illegally issued stock are not entitled to vote thereon. *McManus v. Philadelphia*, etc. R. R. Co., 58 Pa. St. 330.

³ *In re* Election of St. Lawrence Steamboat Co., *supra*.

⁴ *McNeely v. Woodruff*, 13 N. J. L. (1 Green) 352; *Brewster v. Hartley*, 37 Cal. 15; *Ex parte* Holmes, 5 Cow. (N. Y.) 426; *Ex parte* Desdoity, 1 Wend. 98. See §§ 136, 185.

⁵ *Commonwealth v. Bringhurst*, 103 Pa. St. 134; *Philips v. Wickham*, 1 Paige (N. Y.), 590, 598; *People v. Twaddle*, 18 Hun, 427; *Craig v. First Presbyterian Church*, 88 Pa. St. 42; *Taylor v. Griswold*, 14 N. J. L. 222. None of these cases, except the first and last, were cases of stock corporations.

⁶ *People v. Crossley*, 69 Ill. 195; *State v. Tudor*, 5 Day (Conn.) 329. See *Philips v. Wickham*, 1 Paige, 590, 598. Contra, *Taylor v. Griswold*, 14 N. J. L. 222, 228.

cuted with any particular formality.¹ A shareholder represented by proxy at a meeting is chargeable with knowledge of facts connected with the proceedings of that meeting known to his proxy.²

§ 580. At common law each member of a corporation was entitled to one vote; and this rule is still of general application to corporations other than stock corporations. With regard to the latter, by statute and by-laws, and by custom so general as to amount to accepted law, a shareholder is entitled to as many votes as he holds shares.³ A number of shareholders may by agreement combine to control a corporate election and elect proper officers in the best interests of the corporation.⁴ But it has been held that such agreements must not contain provisions restricting the right of shareholders to alienate their shares and vote by proxy.⁵ And in Massachusetts it is held that an agreement between shareholders to vote for one of them or for a third person as manager, and to vote to increase the salaries of all the officers, including the manager, is void as against public policy; at least unless assented to by all the shareholders.⁶

§ 581. A court of law is the proper tribunal to determine the validity of a corporate election. For, unless specially authorized by statute, a court of equity has no authority to try this question, and pronounce judgment of annulment.⁷ But when the question of the validity of a corporate election necessarily arises in the de-

¹ *In re* Election of St. Lawrence Steamboat Co., *supra*; *Matter of Cecil*, 36 How. Pr. (N. Y.) 477.

An irrevocable power of attorney or proxy to a trustee, executed by a number of shareholders, is not against public policy. *Brown v. Pacific Mail S. S. Co.*, 5 Blatchf. 525.

² *Thames v. Central City Ins. Co.*, 49 Ala. 577.

³ The old rule, however, was applied to a stock corporation in *Taylor v. Griswold*, 14 N. J. L. 222, 237. Cumulative voting is authorized by

the constitution of a number of states. See § 577, note.

⁴ *Faulds v. Yates*, 57 Ill. 516; *Havemeyer v. Havemeyer*, 11 J. & S. 506; *aff'd* 86 N. Y. 618; see *Barnes v. Brown*, 80 N. Y. 527, 537.

⁵ *Fisher v. Bush*, 35 Hun (N. Y.), 641.

⁶ *Woodruff v. Wentworth*, 133 Mass. 309; *Guernsey v. Cood*, 120 Mass. 501. See § 788.

⁷ *Mechanics' Nat. B'k v. Burnett M'fg Co.*, 32 N. J. Eq. 236; *Owen v. Whitaker*, 20 N. J. Eq. 122; *Neall v. Hill*, 16 Cal. 146.

termination of a suit properly cognizable by a court of equity, it will determine that question as it would any other question of law or fact necessary to be decided in order to settle the rights of the parties.¹ And a court of equity has jurisdiction of a bill brought by a shareholder to procure the cancellation of illegal shares and incidentally to restrain the holders from voting on them.² Similarly, an injunction may be granted, at the suit of shareholders, restraining other shareholders from voting shares in a manner contrary to the purport of a provision in the charter.³ But, it is submitted, courts should be chary of granting injunctions at the suit of shareholders restraining other shareholders from voting at corporate elections: and certainly a preliminary injunction should not be granted so near the time of an election as to take away the votes of shareholders without giving them a chance to be heard.⁴

§ 582. Every stock corporation has the implied power to make by-laws for the regulation of its affairs;⁵ and the majority may competently pass any reasonable by-law within the general scope of the corporate purposes that is calculated to effect them.⁶ The power to make by-laws is in the shareholders (not in the board of directors) when there is no law or valid usage to the contrary.⁷

Power to
make by-
laws.

¹ *Mechanics' Nat. B'k v. Burnett M'fg Co.*, *supra*. Compare *New England Mut. Life Ins. Co. v. Phillips*, 141 Mass. 535.

² *Wood v. Church B'ld'g Ass'n*, 63 Wis. 9. But it has been held that an injunction will not be granted restraining shareholders from voting on alleged illegal stock, at least unless irreparable (threatened) injury to the plaintiff or the company be shown. *Reed v. Jones*, 6 Wis. 680.

³ *Webb v. Ridgely*, 38 Md. 364. An election of officers may be legal though less than one-half of the stock be voted thereat, the other shares being excluded by injunction. *Brown*

v. Pacific Mail S. S. Co., 5 Blatchf. 525.

⁴ *Hilles v. Parish*, 14 N. J. Eq. 380. Compare § 794.

⁵ *Martin v. Nashville B'ld'g Ass'n*, 2 Coldw. (Tenn.) 418. See also §§ 6, 12, 15, 20.

⁶ See *Carne v. Brigham*, 39 Me. 35; *State v. Tudor*, 5 Day (Conn.), 329. By-laws contained in a book issued to shareholders are evidence against a shareholder in an action by the receiver of the corporation to collect a subscription. *Frank v. Morrison*, 58 Md. 423.

⁷ *Morton Gravel Road Co. v. Wy-song*, 51 Ind. 4; *Carroll v. Mullanphy S'v'gs B'k*, 8 Mo. App. 249.

§ 583. By-laws must be reasonable,¹ and not in contravention of the law written or unwritten, and particularly must not contravene the charter or enabling act and articles of association.² A by-law that would deprive a shareholder of vested rights is invalid,³ as, for instance, one prohibiting a shareholder from alienating his shares.⁴ And a majority cannot by a by-law impose on shareholders individual liability for corporate indebtedness.⁵ A by-law consisting of several distinct and independent parts may be valid in one part and void in another.⁶

§ 584. The authority which is competent to enact by-laws is competent to repeal them;⁷ but no more can their repeal than their passage affect a vested right.⁸

§ 585. A shareholder has a right to inspect the corporate books at reasonable intervals;⁹ and may enforce this right by

¹ *Cartan v. Father Matthew Soc'y*, 3 Daly, 20; *State v. Merchants' Exchange*, 2 Mo. App. 96. Whether a by-law is unreasonable or not is a question solely for the court; but its unreasonableness must be demonstrated. *Hibernia Fire Engine Co. v. Harrison*, 93 Pa. St. 264.

² *Martin v. Nashville B'd'g Ass'n*, 2 Coldw. (Tenn.) 418; *State v. Curtis*, 9 Nev. 325; *Andrews v. Union Mut. Fire Ins. Co.*, 37 Me. 256; *Seneca County Bank v. Lamb*, 26 Barb. 595; *Bergman v. St. Paul Mut. B'd'g Ass'n*, 29 Minn. 275. See *Adley v. Reeves*, 2 Maule & S. 53; *Gordon v. Muchler*, 34 La. Ann. 604. Compare *Goddard v. Merchants' Exchange*, 9 Mo. App. 290; *aff'd* 78 Mo. 609.

³ See *Kent v. Quicksilver M'g Co.*, 78 N. Y. 159, 182; *Pentz v. Citizen's Fire Ins. Co.*, 35 Md. 73. But it is held that a person becoming a member of a corporation (not a stock corporation) may be bound by an agreement that his relations thereto shall be sub-

ject to by-laws then in force or thereafter to be enacted. *Supreme Commandery v. Ainsworth*, 71 Ala. 436.

⁴ *Moore v. Bank of Commerce*, 52 Mo. 377; *In re Klaus*, 67 Wis. 401. Compare *Spurlock v. Pacific Railroad*, 61 Mo. 319.

⁵ *Reid v. Eatonton M'f'g Co.*, 40 Ga. 98; *Trustees v. Flint*, 13 Metc. 539. As to the reasonable construction that should be placed on by-laws, see *In re Dunkerson*, 4 Biss. 227; *State v. Conklin*, 34 Wis. 21.

⁶ *Amesbury v. Bowditch Mut. Fire Ins. Co.*, 6 Gray, 596; *State v. Curtis*, 9 Nev. 325, 337.

⁷ *Smith v. Nelson*, 18 Vt. 511.

⁸ See *Kent v. Quicksilver M'g Co.*, 78 N. Y. 159, 182.

⁹ *Deoderick v. Wilson*, 8 Bax. (Tenn.) 108. See Angell and Ames on Corp., § 681; 2 Lindley on Part., 809-814. Cases in next note. Penalties are sometimes attached by statute to a refusal of corporate officers to allow a shareholder to inspect the books. See *Lewis v. Brainerd*, 53 Vt. 510.

mandamus.¹ His right of inspection may be exercised through an expert or an agent when he is himself too ignorant to exercise it intelligently.² And where shareholders are permitted by the articles to inspect the register, a shareholder (an attorney) may inspect it, although he is really acting in the interests of his clients who are in litigation with the company.³

Right to inspect corporate books.

§ 586. On a transfer of shares legal relations ordinarily cease to subsist between the corporation and the shareholder transferring his shares, and—a novation taking place—attach themselves to the transferee.⁴ It is the American doctrine, however, that a transfer of shares in an insolvent corporation, made to an irresponsible person for the purpose of getting rid of liability on the shares, is void both as to the corporation and as to its creditors.⁵ The

Transfer of shares. Effect. When corporation is insolvent.

¹ *Cockburn v. Union Bank*, 13 La. Ann. 289; *Commonwealth v. Phoenix Iron Co.*, 105 Pa. St. 111; *Stettauer v. N. Y. etc. Cons. Co.*, 42 N. J. Eq. 46; *People v. Lake Shore, etc. R. R. Co.*, 11 Hun, 1; *People v. Pacific Mail S. S. Co.*, 50 Barb. 280. The granting of the writ is discretionary and not reviewable on appeal. *Matter of Sage*, 70 N. Y. 221.

² *State v. Bienville Oil Works Co.*, 28 La. Ann. 204; *Phoenix Iron Co. v. Commonwealth*, 113 Pa. St. 563.

³ *Regina v. Wilts, etc. Canal Navigation*, 29 L. T. N. S. 922.

⁴ This principle is sometimes declared by statute, as in regard to national banks, U. S. Rev. Stat. § 5139. "When an original subscriber to the stock of an incorporated company, who is bound to pay the instalments on his subscription from time to time as they are called in by the company, transfers his stock to another person, such other person is substituted not only to the rights, but to the obligations of the original subscriber; and

he is bound to pay up the instalments called for after the transfer to him. The liability to pay up instalments is shifted from the outgoing to the incoming shareholder. A privity is created between the two by the assignment of the one and the acceptance of the other; and also between them and the corporation, for it would be absurd to say upon general reasoning, that if the original subscribers have the power of assigning their shares, they should, after disposing of them, be liable to the burdens which are thrown upon the owners of the stock." *Angell and Ames on Corp.*, § 534; *Hartford, etc. R. R. Co. v. Boorman*, 12 Conn. 530; *Mann v. Currie*, 2 Barb. 294; *Isham v. Buckingham*, 49 N. Y. 216; *Cowles v. Cromwell*, 25 Barb. (N. Y.) 413. See *Billings v. Robinson*, 94 N. Y. 415.

⁵ *Nathan v. Whitlock*, 9 Paige (N. Y.), 152; *Marcy v. Clark*, 17 Mass. 330; *Rider v. Morrison*, 54 Md. 429. See § 749. A corporation was indebted beyond the amount of its assets.

English cases on the other hand, hold that a shareholder, for the sole purpose of escaping liability, may transfer his shares to a man of straw for a nominal consideration or as a mere gift, even when the company is in a failing condition; and if the transfer be absolute, the transferrer will be freed from his liability.¹ Not so, however, if the transfer be merely colorable, so that the transferee as between himself and his transferrer remains a trustee for the latter.² A transfer to an infant does not divest the transferrer of his liability;³ nor a transfer to the company or to its directors on its account,⁴ or to a mere nominee of the directors.⁵

The defendant, an original subscriber to its stock, and a director, objected to the management, threatening to bring proceedings for a winding up. Thereupon, with the consent of the trustees and all the shareholders who had made any payments on their shares, he transferred his shares, which were not fully paid up, and resigned from his position as trustee, which was taken by his transferee, who on his part agreed to indemnify defendant from further liability on his subscription or to creditors, and loaned to the corporation enough money to make it solvent. The transfer was recorded on the books of the corporation. That the purpose of the whole transaction was to free defendant from all further liability was understood by all. *Held*, that the receiver could not recover from the defendant the unpaid portion of the shares subscribed for by him. The court said that there were no creditors having equities against defendant by virtue of his having been a shareholder, and that the receiver represented only the corporation which had assented to the substitution of the transferee's liability for that of defen-

dant. *Billings v. Robinson*, 94 N. Y. 415.

¹ *In re London, etc. Assurance Co.*, *Jessopp's Case*, 2 DeG. & J. 638; *In re Mexican, etc. Co.*, *De Pass's Case*, 4 DeG. & J. 544; *Harrison's Case*, L. R. 6 Ch. 286; *King's Case*, *ib.* 196; *Master's Case*, L. R. 7 Ch. 296, note; *Williams's Case*, 1 Ch. Div. 576. See Thompson's "Liability of Stockholders," § 213.

² *Chimnock's Case*, Johns. (Eng. Ch.) 714; *In re Mexican, etc. Co.*, *Hyman's Case*, 1 De G. F. & J. 75; *In re Mexican, etc. Co.*, *Costello's Case*, 2 De G. F. & J. 302; *Payne's Case*, L. R. 9 Eq. 223; *In re Bank of Hindustan, Ex parte Kintrea*, L. R. 5 Ch. 95; *Gilbert's Case*, *ib.* 559.

³ *Symon's Case*, L. R. 5 Ch. 298; *Weston's Case*, *ib.* 614; *Castello's Case*, L. R. 8 Eq. 504.

⁴ *Richmond's Ex'rs' Case*, 3 De G. & Sm. 96; *In re Newcastle, etc. Ins. Co.*, *Ex parte Henderson*, 19 Beav. 107; *Daniell's Case*, 22 Beav. 48. In America, however, unless the corporation were insolvent, a transfer to it would be valid for most purposes. See §§ 134, 135, 747.

⁵ *Eyre's Case*, 31 Beav. 177.

§ 587. The transferee (on the books of the corporation) of shares that are not fully paid up is liable for calls made for the unpaid portion during his ownership.¹ A person becomes legally entitled to shares by having them transferred to him on the books of the corporation; a certificate being but evidence.² It is also held that an assignment and delivery of the stock certificate will pass the legal title to shares transferable only on the books of the company, though there be no such transfer.³ And a transferee of shares, who procures a transfer to be made to himself on the books of the corporation, is liable to the assignee in bankruptcy of the corporation, for the unpaid balance on the shares, although he merely holds them as collateral security for the debt of his transferrer.⁴

Liability of
trans-
feree.

§ 588. In a recent New York case a person transferred his shares by delivery of the certificate with a power of attorney, the name of the transferee was entered on the *dividend book*, and the corporation paid him dividends for four years. The stock was not transferred on the transfer book, but no provision in the constitution or by-laws required it. The court held that the corporation could not recover of the transferrer, having so long recognized the transfer, and, the corporation being insolvent, the receiver stood in no better position.⁵

¹ Webster v. Upton, 91 U. S. 65; and Connellsville R. R. Co. v. Clarke, Hartford and N. H. R. R. Co. v. 29 Pa. St. 146; Graff v. Pittsburgh Boorman, 12 Conn. 530; Bend v. and Steubenville R. R. Co., 31 Pa. Susquehanna Bridge Co., 6 Har. & J. St. 489. (Md.) 128; Hall v. United States Ins. Co., 5 Gill (Md.), 484; Merri-
² Hawley v. Upton, 102 U. S. 314; Agricultural Bank v. Burr, 24 Me. 256. See Agricultural Bank v. Wil-
son, ib. 273; First Nat. Bk. v. Gif-
ford, 47 Iowa, 575, 583.
³ Leitch v. Wells, 48 N. Y. 585; Robinson v. National Bank, 95 N. Y. 637.
⁴ Pullman v. Upton, 96 U. S. 328; National Bank v. Case, 99 U. S. 628. So the executor of a shareholder may become liable. See Diven v. Duncan, 41 Barb. 520. See § 741.
⁵ Cutting v. Damerel, 88 N. Y. 410.

A contrary doctrine seems to prevail in Pennsylvania. Pittsburgh, etc. Coal Co. v. Otterson, 4 Weekly Notes of Cases, 545; Frank's Oil Co. v. McCleary, 63 Pa. St. 317; Palmer v. Ridge M'g Co., 34 Pa. St. 288; Canal Co. v. Sansom, 1 Binney, 70, 75. See Messersmith v. Sharon S'v'gs Bk., 96 Pa. St. 440. Compare Pittsburgh

§ 589. The constitution or by-laws of the corporation may contain provisions regulating the transfer of shares. If these provisions are not observed, neither the shareholder nor his transferee may take advantage of their non-observance,¹ though on the one hand the corporation may refuse to recognize an irregular transfer,² and in most cases of irregular transfers the shareholder will not divest himself of any liability toward creditors,³ although liability may attach to his transferee.⁴ If, however, the corporation, or those of its officers who have charge of the transfers of shares, recognize a transfer made in good faith though irregularly, the corporation may be estopped from denying its validity.⁵ And

¹ Johnson v. Underhill, 52 N. Y. 203; Bank of Utica v. Smalley, 2 Cow. (N. Y.) 770; Quiner v. Marblehead Social Ins. Co., 10 Mass. 476; Parrott v. Byers, 40 Cal. 614; Newberry v. Detroit, etc. M'fg Co., 17 Mich. 141; Duke v. Cahawba Nav. Co., 10 Ala. 82; Cheltenham, etc. R'y Co. v. Daniel, 2 Eng. R'y Cas. 728. Compare Weston v. Bear River, etc. Water and M'g Co., 5 Cal. 186; S. C., 6 Cal. 425; Naglee v. Pacific Wharf Co., 20 Cal. 529.

² Holbrook v. Fauquier, etc. Turnpike Co., 3 Cranch Cir. Ct. 425; Hall v. Rose Hill Road Co., 70 Ill. 673; Helm v. Swiggett, 12 Ind. 196; compare State v. New Orleans Gas Light Co., 25 La. Ann. 413; Townsend v. McIver, 2 S. C. 25. A consent of the board of directors to the transfer of stock must, when made necessary, be evidenced by a recorded resolution of the board. Pittsburgh and Connellsville R. R. Co. v. Clarke, 29 Pa. St. 146; *semble*, contra, Ellison v. Schneider, 25 La. Ann. 435. See also regarding the consent of directors to a transfer, Shepherd's Case, L. R. 2 Eq. 564; Slee v. International Bank, 17 L. T. N. S. 425; *In re* Gresham

Life Assurance Soc.; *Ex parte* Penney, L. R. 8 Ch. 446.

³ Shellington v. Howland, 53 N. Y. 371; see § 748. Still it is held in England that if the transferrer has done all in his power to perfect the transfer, he is discharged from his liability as shareholder. Shortridge v. Bosanquet, 16 Beav. 84; Nation's Case, L. R. 3 Eq. 77; Fyfe's Case, L. R. 4 Ch. 768; Ward & Garfit's Case, L. R. 189. But see § 748.

Prima facie a person whose name appears on the books of the corporation is a shareholder as to it and as to the public. State v. Ferris, 42 Conn. 560; Holyoke Bank v. Burnham, 11 Cush. 183; Skowhegan Bank v. Cutler, 49 Me. 315; Matter of Empire City Bank, 18 N. Y. 200; Stanley v. Stanley, 26 Me. 191; Worrall v. Judson, 5 Barb. 210.

⁴ Upton v. Burnham, 3 Biss. 431; Straffon's Exr's Case, 1 De G. M. & G. 576; Cheltenham, etc. R'y Co. v. Daniel, 2 Eng. R'y Cas. 728.

⁵ Isham v. Buckingham, 49 N. Y. 216; Bargate v. Shortridge, 5 H. L. C. 297; Scripture v. Frankestown Soapstone Co., 50 N. H. 571.

if the corporation, on the demand of a transferee of shares, refuses without legal reason, *i. e.*, wrongfully, to register a transfer, it will be deemed to have waived the requirement that transfers shall be registered, and the transferee, as against the corporation, will have the full rights of a shareholder.¹

§ 590. The following is from the opinion of the New York Court of Appeals by Judge Davis in *New York and New Haven R. R. Co. v. Schuyler*:² "Where the stock of a corporation is by the terms of its charter or by-laws transferable only on its books, the purchaser who receives a certificate with power of attorney, gets the entire title, legal and equitable, as between himself and his seller, with all the rights the latter possessed; but as between himself and the corporation he acquires only an equitable title which they are bound to recognize and permit to be ripened into a legal title, when he presents himself, before any effective transfer on the books has been made, to do the acts required by the charter or by-laws in order to make a transfer.³ Until those acts be done he is not a stockholder, and has no claim to act as such, but possesses as between himself and the corporation, by virtue of the certificate and power, the right to make himself, or whomsoever he chooses, a stockholder by the prescribed transfer. The stock not having passed by the delivery of the certificate and power of attorney, the legal title remains in the seller, so far as affects the company and subsequent *bona fide* purchasers who take by transfers duly made on the books. And hence a buyer in good faith of a person in whose name the stock stands on the books, who takes a transfer in conformity to the charter or by-laws, permitted to be made by the authorized officer of the corporation, becomes vested with a complete title to the stock, and cuts off all the rights and equities of the holder of the certificate to the *stock itself*. What other rights and equities he may possess is another question, but if the transferee has taken in good faith, and for value, the stock is gone beyond his reach, and beyond recall by the corporation."

¹ *Robinson v. National Bank*, 95 N. Y. 637.

² 34 N. Y. 30, 80.

³ *Townsend v. McIver*, 2 S. C., 25.

§ 591. The case from which the above citation is taken decided that a corporation is liable in damages to the *bona fide* holder of certificates of shares issued by the proper corporate officers in due form, but fraudulently and in excess of the amount of capital stock authorized by its charter.¹

Liability of corporation for excessive issues.

§ 592. In registering transfers the corporation owes to the individual shareholders the duty to act carefully, and if it fails to exercise proper vigilance it will be liable to the shareholder injured.² Likewise if the corporation has notice that the nominal holder is an executor or trustee, it will be affected with notice of the terms of his trust and will be liable to the beneficiaries if it permit a wrongful transfer to be entered on its books.³ But when an executor has unrestricted power to transfer the assets of his estate, a corporation is not bound to see that he is not defrauding the estate in making transfers of its stocks.⁴

Liability of corporation in registering transfers.

§ 593. A corporation is liable to the lawful owner if it transfers shares on a forged order.⁵ Thus, a bank which has per-

¹ New York and N. H. R. R. Co. v. Schuyler, 34 N. Y. 30; accord, Willis v. Fry, 13 Phila. (Pa.) 33; Titus v. Great Western Turnpike Road, 5 Lans. (N. Y.) 251. Compare Wright's Appeal, 99 Pa. St. 425. See § 598.

But a corporation cannot be compelled to transfer stock issued in contravention to the act of incorporation. People v. Sterling M'f'g Co., 82 Ill. 457.

² Pennsylvania R. R. Co.'s Appeal, 86 Pa. St. 80; Caulkins v. Gas Light Co., 85 Tenn. 683; Woodhouse v. Crescent Mut. Ins. Co., 35 La. Ann. 238. Plaintiff need not sue to have the transfer set aside, but may sue the corporation for the value of his stock. *Ib.*; see Keppel's Admr's v. Petersburg R. R. Co., Chase's Dec. 167; Telegraph Co. v. Davenport, 97 U. S. 369; Sewall v. Boston Water Power Co., 4 Allen, 277.

³ Stewart v. Firemen's Ins. Co., 53 Md. 564; Lowry v. Commercial, etc. Bank, Taney's Dec. 310; Webb v. Graniteville M'f'g Co., 11 S. C. 396; Caulkins v. Gas Light Co., 85 Tenn. 683; Magwood v. Railroad Bank, 5 S. C. 379.

⁴ Crocker v. Old Colony R. R. Co., 137 Mass. 417. A corporation cannot require an executor to leave with it certified copies of the will, etc., which he furnishes as proof of his authority. Bird v. Chicago, etc. R. R. Co., 137 Mass. 428.

⁵ Brisbane v. Delaware, etc. R. R. Co., 94 N. Y. 204; Midland R'y Co. v. Taylor, 8 H. L. C. 751; Sewall v. Boston Water Power Co., 4 Allen, 276; Pratt v. Taunton Copper Co., 123 Mass. 110; Loring v. Salisbury Mills, 125 Mass. 138; Machinists' Nat. Bk. v. Field, 126 Mass. 345; Pratt v. Boston and Albany R. R. Co., *ib.* 443;

mitted a transfer of shares to be made on a forged power of attorney, may be compelled to issue new certificates to the shareholder to whom the shares belonged, and account to him for dividends paid on them.¹ And if A. in good faith purchases shares from a shareholder who himself has bought on the faith of forged transfers which the company had registered, and the company registers A. as a shareholder, but, subsequently, discovering the forgery, erases his name, he will be entitled as against the company to be placed in as good a position—by award of damages or delivery of other shares—as he would have been in had the transfers been valid.² But the simple fact that the company has registered a forged transfer, using due care, does not estop it from contesting the validity of the certificate which it has forwarded to the purchaser,³ for in such a case the purchaser did not act on the faith of the company's action.⁴

Registry of transfers on forged orders;

§ 594. A corporation will also be liable to the holder of a stock certificate for damages arising from a transfer which it permits to be made in violation of its own regulations. Thus, where stock is transferable on the books of the company only on surrender of the certificates, and a by-law further provides that no new certificate shall be issued until the previous certificate shall have been cancelled, if the corporation issues new certificates to a former holder who represents that he has lost his certificates, but who has really transferred them for a valuable consideration, the corporation will be liable to the transferee for the value of the stock, but not for dividends, as a production of certificates was not required for their collection.⁵

In violation of by-laws :

Swan v. North British, etc. Co., 7 H. & N. 603; S. C., on Appeal, 2 H. & C. 175.

¹ Pollock v. National Bank, 7 N. Y. 274; Blaisdell v. Bohr, 68 Ga. 56.

² *In re Bahia*, etc. R'y Co., 37 L. J. Q. B. 176. See *Savings Bank v. Baltimore*, 63 Md. 6.

³ *Waterhouse v. London and S. W. R. Co.*, 41 L. T. N. S. 553; see also *Simm v. Anglo-American Telegraph Co.*, 5 Q. B. Div. 188.

⁴ *Simm v. Anglo-American Telegraph Co.*, *supra*; see §§ 597, 598.

⁵ *Cleveland and Mahoning R. R. Co. v. Robbins*, 35 Ohio St. 483; *Bank v. Lanier*, 11 Wall. 369; *Conklin v. Second Nat. Bk.*, 45 N. Y. 655; *Strange v. H. and T. C. R. R. Co.*, 53 Tex. 162. See *Baker v. Wasson*, ib. 150; *Cushman v. Thayer M'f'g Co.*, 76 N. Y. 365.

§ 595. If, however, a corporation using proper care and violating none of its regulations, transfers shares unwittingly in disregard of rights with notice of which it is in no way affected, it will not be liable.¹ Thus, where shares standing on the books of the corporation in the name of a judgment debtor, are sold by the sheriff as the debtor's property, and a court of last resort, after a fair contest by the corporation, orders the stock to be transferred to the purchaser under the sheriff's sale, the corporation is not liable to the holder of the certificate who took no steps to protect himself.² Again, if the plaintiff is the equitable owner of shares standing in the name of another who claims to be the absolute owner of them, the plaintiff cannot recover their value from the corporation on its refusal to issue certificates to him. Under such circumstances the corporation is not bound to take on itself the peril of issuing the certificates, and thus deciding between rival claimants.³ In a suit against a corporation by a person who claims to be the owner of stock standing in the name of another, and alleged to have been illegally transferred on the books of the company, the demand, if for damages, must be based on allegations of wrongful acts on the part of the corporation; and if the demand is for the recovery of the stock itself, the person to whom it has been transferred is a necessary party.⁴

§ 596. Accordingly, a corporation may maintain a bill of interpleader against two opposing claimants of a dividend due on shares of its capital stock, originally held in trust for one of them by a third person who had fraudulently transferred them to the other through mesne conveyances. Upon such bill the court may determine which claimant is entitled to the dividend, but not whether

¹ See *Williams v. Mechanics' Bank*, 5 Blatchf. 59. Compare *Dickinson v. Central National Bank*, 129 Mass. 279.

² *Friedlander v. Slaughter House Co.*, 31 La. Ann. 523.

³ *National Bank v. Lake Shore, etc. R. R. Co.*, 21 Ohio St. 221. Compare *Baker v. Marshall*, 15 Minn. 177.

A judgment decreeing against a corporation that the plaintiff is the owner of stock evidenced by a lost certificate, should provide for indemnity from the plaintiff to the corporation. *Galveston City Co. v. Sibley*, 56 Tex. 269.

⁴ *Reid v. Commercial Ins. Co.*, 32 La. Ann. 546.

the corporation is liable to the one defrauded, for permitting the transfer to be made.¹ A corporation, cannot, however, sustain a bill of interpleader to force opposing claimants to contest with each other the ownership of shares, when the corporation has already issued a certificate to one of them; since, under such circumstances, it would have to admit that as to one of the contestants it was a wrong-doer.²

§ 597. If a corporation by mistake or in ignorance of material facts registers an improper transfer or issues a certificate, it is not precluded from denying as against the transferee his title as shareholder.³ But it cannot impugn his title under such circumstance, to the injury of subsequent purchasers who, on the faith of the company's action, have bought the shares without notice of any impropriety.⁴ In a recent Maryland case a savings bank made a loan on the security of a stock certificate on which the indorsement for transfer was forged. The borrower afterwards applied for a further loan, and the bank assented on condition that the cor-

Registry of
transfer by
mistake.

¹ *Salisbury Mills v. Townsend*, 109 Mass. 115.

² *Mount Holly Turnpike Co. v. Ferree*, 17 N. J. Eq. 117.

³ *Wright's Appeal*, 99 Pa. St. 425; *Houston, etc. R'y Co. v. Van Alstyne*, 56 Tex. 439; *Central R. R. Co. v. Ward*, 37 Ga. 515; *Hare v. London and N. W. R'y Co., Johns.* (Eng.) 722.

In a Massachusetts case the defendant, in good faith, presented to plaintiff for a transfer a certificate of plaintiff's stock, on which the owner's name to the power of attorney on the back had been forged. Afterwards defendant sold the stock to a third person, to whom, on defendant's request, the plaintiff issued a new certificate. Thus the plaintiff had no remedy against such third person, being estopped as to him; and having been forced to issue equivalent certificates to the real owner, was damaged. *Held*, it could

maintain an action against defendant, and as damages could recover the costs and expenses of the suit (exclusive of counsel fees) by which plaintiff had been forced to issue new certificates to the real owner, plaintiff having notified defendant to defend that suit; also the amount paid in good faith by plaintiff for the equivalent shares with which it replaced the shares transferred on the forgery, and this although the stock was then of a higher value in the market than at the time when the forgery was committed; and also the dividends which plaintiff had had to pay the real owner. *Boston and A. R. R. Co. v. Richardson*, 135 Mass. 473.

⁴ See *Ward v. South Eastern R'y Co.*, 2 E. & E. 812; *Hart v. Frontino, etc. Mining Co.*, L. R. 5 Ex. 111; *Boston and A. R. R. Co. v. Richardson*, 135 Mass. 473; *Metro-politan Savings Bank v. Baltimore*, 63 Md. 6.

poration should make out a new certificate to the bank. This the corporation did, and the bank on the security of the new certificate made a further loan. When the forgery was discovered the bank brought suit against the corporation, and was allowed to recover the amount of the second loan, but not the amount of the first.¹

§ 598. Accordingly, a certificate of stock in a corporation, under the corporate seal, and signed by the officers authorized to issue certificates, estops the corporation to deny its validity as against one who has taken it for value without knowledge or notice of any fact tending to show that it has been irregularly issued.² And con-

Estoppel of corporation by its certificate.

¹ Metropolitan Savings Bank v. Baltimore, 63 Md. 6.

² Moores v. Citizens' National Bank, 111 U. S. 156, 165. In this case the plaintiff lent money to the cashier of a bank for his own use, and took from him as security a certificate of stock written by him on one of the printed forms which the president had signed and left with the cashier to be used if needed in the president's absence. The certificate certified that the plaintiff was the owner of the stock "transferable only on the books of the bank on the surrender of this certificate," and the by-laws did in fact provide that certificates should be issued only on surrender of the former certificate. The cashier falsely represented to the plaintiff that he owned the stock in question and had transferred it to the plaintiff. The cashier did not surrender any certificate to the bank, or make any transfer on its books to the plaintiff; he never repaid the money loaned and was insolvent. The bank never ratified or received any benefit from the transaction. *Held*, on the refusal of the bank to recognize the certificate as valid, the plaintiff could not recover from the bank its value,

and could not sustain her case by evidence that in one or two other instances the cashier had issued certificates without any certificate being surrendered.

The court further held that the representations of the cashier, beyond those in the certificate, were made by him personally, and not on behalf of the bank. "The duty of transferring his stock to the plaintiff before taking out a new certificate in her name was a duty that he and not the bank owed to the plaintiff. The making of such a transfer was an act to be done by him in his own behalf as between him and the plaintiff, and in the plaintiff's behalf as between her and the bank. The very form of the certificate was such as to put her on her guard." Plaintiff "was not applying to the bank to take stock as an original subscriber or otherwise; but she was bargaining with the cashier for his stock, which she supposed him to hold as his own; she knew that she had not held or surrendered any certificate, and she never asked to see his certificate or a transfer thereof to her; and he in fact made no surrender to the bank or transfer on its books; she relied on his personal representation as the party

sequently, as a general rule, a person purchasing shares need not, in the absence of circumstances putting him on his inquiry, look beyond the certificate delivered to him for the title of his vendor.¹ For if a corporation competently issues a certificate in which it affirms that the person named therein is entitled to a certain number of shares, it holds out to all who may deal with him in good faith, that he owns and has capacity to transfer them.²

§ 599. The purchaser of a stock certificate regular on its face, who is willing to comply with the corporate regulations respecting the transfer of shares, may maintain an action in equity against the corporation to compel it to transfer the shares to him.³ Or, on the refusal of

Right of purchaser to a transfer; to damages.

with whom she was dealing that he had such stock; and she trusted him as her agent to see the proper transfer thereof made on the books of the bank. Having distinct notice that the surrender and transfer of a former certificate were prerequisites to the lawful issue of a new one, and having accepted a certificate that she owned stock, without taking any steps to assure herself that the legal prerequisites to the validity of her certificate, which were to be fulfilled by the former owner and not by the bank, had been complied with, she does not, as against the bank, stand in the position of one who receives a certificate of stock from the proper officers without notice of any facts impeaching its validity.' *Moore v. Citizens' National Bank*, 111 U. S. 156, 164, opinion of court per Gray, J.

¹ *Salisbury Mills v. Townsend*, 109 Mass. 115; *Lowry v. Commercial*, etc. Bank, Taney's Dec. 310. See *Western Maryland R. R. Co. v. Franklin Bank*, 60 Md. 36. But see *Shropshire Union R'y Co. v. The Queen*, L. R. 7 H. L. 496. A stock certificate is transferable by a blank indorsement which the holder may fill up by writ-

ing an assignment and power of attorney above it. *Kortright v. Buffalo Commercial Bank*, 20 Wend. 91; *Leavitt v. Fisher*, 4 Duer (N. Y.), 1. But see *Dunn v. Commercial Bank*, 11 Barb. 580. Compare *Shaw v. Spencer*, 100 Mass. 382. A power of attorney executed in blank is authority to the holder to fill up the blank and demand a transfer. *German Un. B'd'g Ass'n v. Sendmeyer*, 50 Pa. St. 67.

² *Holbrook v. New Jersey Zinc Co.*, 57 N. Y. 616; *Tome v. Parkersburg Branch R. R. Co.*, 39 Md. 36; *Shaw v. Port Philip, etc. M'g Co.*, 13 Q. B. Div. 103. See *Western Maryland R. Co. v. Franklin Bank*, 60 Md. 36. Compare *Mechanics' Bank v. New York and N. H. R. R. Co.*, 13 N. Y. 599; *Central R. R. Co. v. Ward*, 37 Ga. 515; see § 591.

³ *Driscoll v. West Bradley, etc. M'f'g Co.*, 59 N. Y. 96; *Cushman v. Thayer M'f'g Co.*, 76 N. Y. 365; *Hill v. Rockingham Bank*, 44 N. H. 567; *Dayton Nat. Bk. v. Merchants' Nat. Bk.*, 37 Ohio St. 208; *Sibley v. Quinsigamond Nat. Bk.*, 133 Mass. 515; *Iron R. R. Co. v. Fink*, 41 Ohio St.

the corporation to make the transfer, he may sue it for damages,¹ and as damages recover the market value of the shares at the time of its refusal.² If, however, the relief demanded is in the alternative for specific performance or for damages, a judgment for damages is improper unless it appears that the corporation is unable to deliver the shares or similar ones.³ And when a person whom a corporation refuses to recognize as a shareholder, elects to treat such refusal as a conversion of the shares and sues for damages in trover, he can maintain no action for dividends declared after the commencement of his suit.⁴ The great preponderance of authority is that *mandamus* will not lie to compel a corporation to transfer shares.⁵

321. (At least if a recovery of damages for a refusal to transfer would be inadequate.) See *Townsend v. McIver*, 2 S. C. 25. The corporation and the person in whose name the shares stand are always necessary parties to a suit to compel a transfer. *St. Louis and S. F. Ry. Co. v. Wilson*, 114 U. S. 60. A bill in equity to compel a transfer of shares on the books of a corporation does not lie when by statute plaintiff's title is complete without a transfer. *Lippett v. American Wood Paper Co.*, 14 R. I. 301.

¹ *Kortright v. Buffalo Commercial Bank*, 20 Wend. 91; S. C., 22 Wend. 348; *Bank of Attica v. Manufacturers' Bank*, 20 N. Y. 505; *De Comeau v. Guild Farm Oil Co.*, 3 Daly, 218; *North America Building Ass'n v. Sutton*, 35 Pa. St. 463; *German Union B'd'g Ass'n v. Sendmeyer*, 50 Pa. St. 67; *Helm v. Swiggett*, 12 Ind. 194; *Galbraith v. Building Ass'n*, 43 N. J. L. 389; *Durham v. Monumental Silver M'g Co.*, 9 Oreg. 41; *State v. Rombauer*, 46 Mo. 155; *Baltimore City Passenger R'y Co. v. Sewell*, 35 Md. 238; *Protection Life Ins. Co. v. Osgood*, 93 Ill. 69; *Case v. Bank*, 100

U. S. 446. See *Arnold v. Suffolk Bank*, 27 Barb. 424.

² *German Union B'd'g Ass'n v. Sendmeyer*, 50 Pa. St. 67; *Van Die-men's Land Co. v. Cockerell*, 1 C. B. N. S. 732. See *West Branch, etc. Canal Co.'s Appeal*, *81 Pa. St. 19. Trover lies against a corporation for the conversion by it of shares of its stock belonging to plaintiff. *Budd v. Street Ry. Co.*, 12 Oreg. 271.

³ *Otter v. Brevoort Petroleum Co.*, 50 Barb. 247.

⁴ *Hughes v. Vermont Copper M'g Co.*, 72 N. Y. 207.

⁵ *The King v. Bank of England*, 2 Dougl. 524; *Ex parte Fireman's Ins. Co.*, 6 Hill, 243; *Galbraith v. Building Ass'n*, 43 N. J. L. 389; *State v. Rombauer*, 46 Mo. 155; *Baker v. Marshal*, 15 Minn. 177; *Townes v. Nichols*, 73 Me. 515; *Freon v. Carriage Co.*, 42 Ohio St. 30.

Contra, *Green Mount, etc. Turnpike Co. v. Bulla*, 45 Ind. 1. Perhaps a *mandamus* might be sustained if the plaintiff's right to the shares were clear, and it appeared that he would be injured unless he were allotted the very shares demanded. *Durham v. Monumental Silver M'g Co.*, 9 Oreg.

§ 600. A corporation has no implied lien on its shares for calls or other debts owing it from shareholders, and consequently no implied right to refuse to register a transfer because the transferrer is indebted to it.¹ It has been held, however, that a shareholder in a bank who borrows money of it with full notice of its usage not to permit a transfer of shares while the holder is indebted to it, is bound by such usage, and neither he nor his assignees under a voluntary general assignment can maintain an action against the bank for refusing to permit a transfer under such circumstances.²

Lien of a corporation on its shares.

§ 601. As to whether a corporation has the implied power to pass a by-law giving itself a lien on its shares for the holders' indebtedness to it, the authorities conflict. A number of decisions hold it competent for a corporation to pass such a by-law,³ and the preponderance of authority is certainly to the effect that a general power possessed by a corporation to regulate the transfer of its shares authorizes it to create by a by-law a lien on them in its own favor.⁴ But even this last proposition has been disapproved;⁵ and many cases strenuously deny any

41; *Townes v. Nichols*, 73 Me. 515. In *State v. Cheraw, etc. R. R. Co.*, 16 S. C. 524, *mandamus* was granted to compel a railroad company to issue shares of preferred stock to a county.

¹ *Steamship Dock Co. v. Heron's Administratrix*, 52 Pa. St. 280; *Driscoll v. West Bradley, etc. M'fg Co.*, 59 N. Y. 96; *Mobile Mut. Ins. Co. v. Cullum*, 49 Ala. 558; *Farmers', etc. Bank v. Wasson*, 48 Iowa, 336; *Williams v. Lowe*, 4 Neb. 382, 398, and cases in following notes. A shareholder in a bank died insolvent and indebted to the bank. After his death the bank went into liquidation and asserted a right to retain the decedent's *pro rata* share of its assets on account of his indebtedness. But it was held that the bank having no lien by its charter could not hold the money

as against the administrator of the decedent's estate, who claimed it for distribution among decedent's creditors. *Merchants' Bank v. Shouse*, 102 Pa. St. 488.

² *Morgan v. Bank of North America*, 8 S. & R. (Pa.) 73. See also *Vansands v. Middlesex County Bank*, 26 Conn. 144.

³ *Child v. Hudson's Bay Co.*, 2 P. Wms. 207; *In re Bachman*, 12 Nat. B'k'y Reg. 223; *Tuttle v. Walton*, 1 Ga. 43; *Geyer v. Insurance Co.*, 3 Pittsburgh, 41. See *Brent v. Bank of Washington*, 10 Pet. 596, 616.

⁴ *Lockwood v. Mechanics' Nat. B'k.*, 9 R. I. 308; *Pendergast v. Bank of Stockton*, 2 Sawyer, 108; *Cunningham v. Alabama Life Ins. Co.*, 4 Ala. 652; *Geyer v. Ins. Co.*, 3 Pittsburgh, 41.

⁵ See *Driscoll v. West Bradley, etc.*

implied power in a corporation to pass a by-law which creates a lien on its shares, or in any material way interferes with their transferability.¹ But in order to decide some of the cases where the opinion of the court in terms denies the power of a corporation to pass a by-law of this character, it was only necessary to hold (what these cases also hold with perfect justice on their side, and little or no authority against them), that the rights of a person purchasing shares without actual notice of such a by-law are not affected by it.²

§ 602. It may also be held contrary to public policy to allow certain corporations to acquire a lien on their shares. Thus, a national bank organized under the act of 1864, cannot even by provisions in its articles of association and by-laws, acquire a lien on its own shares for debts owing it from shareholders; as that would be against the spirit and policy of the act.³ But a national bank may have a right to hold a cash dividend as pledged for a debt owing it from a shareholder.⁴

§ 603. When by statute a corporation has a lien on its shares for debts owing it from shareholders, its lien is binding as to shareholders, their creditors and assignees in insolvency, and also as to persons who purchase shares

Effect of
lien ;

M'f'g Co., 59 N. Y. 96; Chouteau Spring Co. v. Harris, 20 Mo. 382; Moore v. Bank of Commerce, 52 Mo. 377.

¹ Mobile Mut. Ins. Co. v. Cullum, 49 Ala. 558; Carroll v. Mullanphy S'v'gs Bk., 8 Mo. App. 249; Driscoll v. West Bradley, etc. M'f'g Co., *supra*; Bank of Attica v. Manufacturers' Bank, 20 N. Y. 505; Bryon v. Carter, 22 La. Ann. 98; People v. Crockett, 9 Cal. 112; Moore v. Bank of Commerce, 52 Mo. 377; Farmers', etc. Bank v. Wasson, 48 Iowa, 336. See Steamship Dock Co. v. Heron's Administratrix, 52 Pa. St. 280; Nesmith v. Washington Bank, 6 Pick. 324; Weston's Case, L. R. 4 Ch. 20; Robinson v. Chartered Bank, L. R. 1 Eq. 32; Anglo California Bank v.

Granger's Bank, 63 Cal. 359. Compare Walker's Case, L. R. 2 Eq. 554.

² Farmers', etc. Bank v. Wasson, 48 Iowa, 336; Discroll v. West Bradley, etc. M'f'g Co., 59 N. Y. 96; Bank of Attica v. Manufacturers' Bank, 20 N. Y. 505; Bank of Holly Springs v. Pinson, 58 Miss. 421. See People v. Crockett, 9 Cal. 112. For the general rule is that outsiders are not affected with notice of the by-laws of a corporation. See §§ 196, 197.

³ Bullard v. Bank, 18 Wall. 589; Delaware, L. & W. R. R. Co. v. Oxford Iron Co., 38 N. J. Eq. 340. But see Young v. Vough, 23 N. J. Eq. 325. Compare Bank v. Lanier, 11 Wall. 369; Conklin v. Second Nat. B'k, 45 N. Y. 655.

⁴ Hager v. Union Nat. Bank, 63 Me. 509.

from prior holders¹ or take them as collateral security.² Accordingly, if a corporation has a statutory lien on its shares for unpaid subscriptions, it may refuse a certificate to a purchaser for value from a prior holder until the subscription due on the shares purchased is paid. Under such circumstances the purchaser acquires as against the corporation only the rights of the prior holder.³

§ 604. Unless expressly restricted to a certain class of debts, a statutory lien covers all debts owing from the shareholder to the corporation.⁴ A provision in the articles of a bank that the shares of its stock should not be transferable until the shareholder should discharge all debts *due* by him to the bank, includes liabilities not yet matured, and creates a valid lien as against an assignee of the shares, who takes with notice while the shareholder is under a contingent liability as indorser, and does not inform the bank of his claim until after the indorser's liability has become fixed.⁵ And when a bank has a lien on its shares for all indebtedness of the shareholder, its lien covers not only the indebtedness of the legal holder, but also of a subsequent transferee whose title has not yet been perfected, but who has become the equitable owner.⁶

§ 605. After a bank, which has, by its charter, a lien on its shares, has applied the proceeds arising from a sale of shares to the satisfaction of a debt due from the holder, it will be postponed until the general creditors of the holder shall have been made equal out of his other estate, the residue of which will thereupon be distributed *pro rata*.⁷

¹ Union Bank v. Laird, 2 Wheaton, 390; McCready v. Rumsey, 6 Duer (N. Y.), 574; Tuttle v. Walton, 1 Ga. 43. See Dobbins v. Walton, 37 Ga. 614. Compare St. Louis Perpetual Ins. Co. v. Goodfellow, 9 Mo. 149; Bryon v. Carter, 22 La. Ann. 98.

² Mount Holly Paper Co.'s Appeal, 99 Pa. St. 513; Platt v. Birmingham Axle Co., 41 Conn. 255; Bradford Banking Co. v. Briggs, 31 Ch. Div. 19. Such a lien, given by statute, will be recognized and given effect to in another state. Bishop v. Globe Co., 135 Mass. 132.

³ McCready v. Rumsey, 6 Duer, 574. See also Spurlock v. Pacific Railroad, 61 Mo. 319.

⁴ Mobile Mut. Ins. Co. v. Cullom, 49 Ala. 558. See Schmidt v. Hennepin, etc. Co., 35 Minn. 511.

⁵ Leggett v. Bank of Sing Sing, 24 N. Y. 283. Compare Kahn v. Bank of St. Joseph, 70 Mo. 262.

⁶ Planters', etc. Mut. Ins. Co. v. Selma S'v'gs Bank, 63 Ala. 585.

⁷ German Security Bank v. Jefferson, 10 Bush (Ky.), 326. Compare Petersburg Savings, etc. Co. v. Lumsden, 75 Va. 327.

§ 606. By issuing a new certificate to a transferee of shares in which certificate is expressly stated that the shares are transferable after the liabilities of the holder to the bank are discharged, a bank waives any lien it may have had for the debts of the prior holder.¹ But when a bank has a lien by its charter, it does not waive its lien by using stock certificates (on their face transferable only on the books of the bank) which make no mention of the lien; for a person purchasing or lending money on the security of the shares is affected with notice of the lien.² When a bank releases its lien for a specified time, and within that time the shares are pledged for a debt, the right of the bank after the expiration of the time to re-acquire its lien is subordinate to the right of the pledgee, until the debt for which the shares were pledged is paid, or the pledge released.³

§ 607. In another case a bank charter contained the following provision: "The stock of the bank shall be assignable and transferable on the books of the corporation only, and in the presence of the president or cashier, in such manner as the by-laws shall ordain; but no stockholder indebted to the bank for a debt actually due and unpaid shall be authorized to make a transfer or receive a dividend until such debt is discharged, or security to the satisfaction of the directors given for the same." A., a shareholder indebted to the bank, delivered his stock certificate with power of sale to B. as collateral security for a debt. On default of payment, B. sent the certificate to the cashier,

¹ Hill v. Pine River Bank, 45 N. H. 300.

² Bohmer v. City Bank, 77 Va. 445.

³ Bank of America v. McNeil, 10 Bush (Ky.), 54. A clause in a charter that no shareholder shall sell his shares without giving the corporation ten days' refusal of them, applies only to voluntary sales; and does not affect the rights of a purchaser at a sheriff's sale on an execution. Barrows v. National Rubber Co., 12 R. I. 173. A railroad company issued conditional stock certificates, for which ordinary

stock certificates were to be exchanged when the notes given to secure the payment of the subscription were paid. It negotiated these notes, and afterwards issued unconditional certificates to the original subscribers, who were the makers of the notes. The makers failed to pay the notes, and the company was held liable to pay the judgments recovered by the holders against the makers, to the extent of the value of the unconditional certificates. Houston, etc. Ry. Co. v. Bremond, 66 Tex. 159.

who made the requisite entries on the stock-ledger, where it was his practice to keep account of transfers without consulting in each case the directors, who had adopted no by-law regulating the matter. The cashier then sold a portion of the shares for B. on B.'s power of attorney, having told B. that he needed no certificate. Subsequently A. became insolvent, being indebted to the bank. It was held that as between A. and B. the title to the shares passed by A.'s delivery of the certificate; also, that the acts of the cashier were binding on the bank, and the transfer made by him on the stock-ledger vested in B. a complete and unincumbered title to the shares with a right to the usual certificate; and it was further held that even if B. had acquired merely an equity based on an executory contract for a transfer, the right of the bank to assert its lien was lost by its laches, and the enforcement of its lien would have operated as a fraud.¹

§ 608. Although it would seem that there is no method by which a shareholder can, against the will of the majority, force the corporation to continue its operations, a shareholder has important rights respecting the manner of discontinuing the business and winding up the corporate affairs.² Thus, where a statute provides a way for winding up a company or reducing its capital stock, the company cannot in a way unauthorized by the statute, against the will of a dissentient shareholder, purchase its own shares with a view to dividing its assets. And in such a case a clause in the articles of association, that the shares of any shareholder who begins directly or indirectly a suit against the company or the directors, shall be forfeited on payment to him of their full market value, cannot avail the company.³ It has also been held that the directors and a majority of shareholders cannot sell out the entire property of a solvent and

Rights of shareholders in respect of winding up.

¹ National Bank v. Watson town Bank, 105 U. S. 217.

² But a subscriber who has never paid anything on his shares, and whose shares have been forfeited, has no standing as a shareholder to object

to the disposition made of corporate funds on dissolution. St. Louis, etc. Coal, etc. Co. v. Sandoval Coal, etc. Co., 116 Ill. 170.

³ Hope v. International Financial Society, L. R. 4 Ch. Div. 327.

paying railroad company against the consent of a minority.¹ And a railroad company has no authority to sell, or lease *in perpetuum*, all its property and business to another corporation, and compel a dissenting shareholder to accept stock in the other company, or a fixed and arbitrary price per share of its own stock.²

§ 609. Nevertheless, if under the authority of the board of directors, whose action is ratified by the holders of all the stock represented at a shareholders' meeting, a conveyance is made of the total assets of a corporation in payment of its sole debt, the conveyance will be valid as against other shareholders, when there is no fraud and a continuance of the business would have been ruinous.³

§ 610. The majority of shareholders, moreover, acting as the body corporate, may, when the rights of the state do not prevent, dissolve the corporation and wind up its affairs.⁴ Likewise it is held competent for the shareholders by a by-law adopted at their first meeting to

Power of majority to dissolve; of minority.

¹ Kean v. Johnson, 9 N. J. Eq. 401.

The owners of a majority of shares of a corporation under the form of dissolving it and disposing of its property and distributing the proceeds, became the purchasers of such property at an unfair price, through a new corporation, in which they were shareholders, to the exclusion of the minority shareholders in the old corporation. In a suit in equity by the latter against the new corporation, it was held that plaintiffs had a lien, to the extent of the moneys of which they had been deprived by the sale, on the property of the old corporation in the hands of the new. *Ervin v. Oregon Ry. etc. Co.*, 23 Blatchf. 517. The court followed the idea that when a majority combine, they constitute themselves the corporation, and so are bound to exercise their powers with due regard to the interests of the minority. See also *Meeker v. Winthrop Iron Co.*, 17 Fed. Rep. 48.

² Boston and Providence R. R. Co. v. New York and N. E. R. R. Co., 13 R. I. 260; *Mason v. Pewabic M'g Co.*, 25 Fed. Rep. 882. See also *Frothingham v. Barney*, 6 Hun, 366; *Taylor v. Earle*, 8 Hun, 1; *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 42; *In re Empire Assurance Co.*, *Ex parte Bagshaw*, L. R. 4 Eq. 341; *Clinch v. Financial Co.*, L. R. 4 Ch. 117; *McCurdy v. Myers*, 44 Pa. St. 535. Compare *Buford v. Keokuk Northern Packet Co.*, 3 Mo. App. 159.

³ *Hancock v. Holbrook*, 9 Fed. Rep. 353. See also *Buford v. Keokuk Northern Packet Co.*, 3 Mo. App. 159; *Sheldon Hat Blocking Co. v. Eickemeyer Hat Blocking, etc. Co.*, 90 N. Y. 607.

⁴ *Treadwell v. Salisbury M'fg Co.*, 7 Gray, 393; *Lauman v. Lebanon Valley R. R. Co.*, 30 Pa. St. 42; *Merchants', etc. Line v. Wagner*, 71 Ala. 581. See *Webster v. Turner*, 12 Hun,

limit the term of the corporate existence.¹ But a minority cannot compel a dissolution unless there exist most substantial reasons against the further prosecution of the corporate enterprise;² nor has the minority, in the absence of fraud or wrongdoing on the part of the directors, an absolute right to have a receiver of the corporate property appointed, although the corporation be utterly insolvent; this last being discretionary with the court.³ Thus, it is no ground for dissolving a manufacturing corporation on the petition of shareholders—a majority in number though a minority in interest—that a person owning a majority of stock has for many years controlled the election of officers and elected himself agent; and that he has for a long time “managed the affairs of said corporation according to his own will and choice, regardless of the wishes and interests of the other stockholders;” that, according to his statement, the corporation has been doing a losing business, that he refuses to purchase the shares of complainants, and that if the affairs of the corporation were properly managed the business might be a source of profit to all.⁴

§ 611. Independent of statute, moreover, a court of equity has no power to dissolve a corporation and divide its property at the suit of a shareholder,⁵ or remove corporate officers.⁶ Under statutes in some of the

Jurisdiction of equity.

264; *Ervin v. Oregon Ry., etc. Co.*, 23 Blatchf. 517. In regard to national banks the statute (U. S. Rev. St., § 5220) provides that they may go into liquidation and be closed by a vote of the shareholders owning two-thirds of the stock.

¹ *Merchants', etc. Line v. Wagner*, 71 Ala. 581.

² See matter of *Pyrolusite Manganese Co.*, 29 Hun, 429. It has been held that an insolvent corporation may be dissolved at the suit of a shareholder. *Masters v. Eclectic Life Ins. Co.*, 6 Daly, 455. But see *Denike v. New York, etc. Lime Co.*, 80 N. Y. 599; *Hardon v. Newton*, 14 Blatchf. 376.

³ *Denike v. New York, etc. Lime Co.*, 80 N. Y. 599. See *Hardon v. Newton*, 14 Blatchf. 376.

⁴ *Pratt v. Jewett*, 9 Gray, 34.

⁵ *Strong v. McCagg*, 55 Wis. 624; *Bayless v. Orne*, 1 Freem. Ch. (Miss.) 161; *Howe v. Deuel*, 43 Barb. 504; *Belmont v. Erie R'y Co.*, 52 Barb. 637; *Waterbury v. Merchants Un. Exp. Co.*, 50 Barb. 157; *Fountain Ferry Turnpike Co. v. Jewell*, 8 B. Mon. (Ky.) 140. Compare *Baker v. Backus*, 32 Ill. 79; *Terhune v. Midland R. R. Co.*, 38 N. J. Eq. 423; *Baker v. Louisiana Portable R. R. Co.*, 34 La. Ann. 754.

⁶ *Neall v. Hill*, 16 Cal. 146. See § 581.

states, however, an information in the nature of a *quo warranto* may be filed at the relation of a shareholder against an illegally existing corporation to compel a dissolution.¹ And, finally, a court has power, on the application of a shareholder, to open or vacate a judgment dissolving a corporation, although the shareholder was not a party to the action instituted by the attorney-general, when it is shown the court that there is reasonable ground to believe that there was fraud or collusion in obtaining the judgment operating to the injury of the shareholder.²

¹ See *Albert v. State*, 65 Ind. 413.

² *People v. Hectograph Co.*, 10 Abb. N. C. (N. Y.) 358.

CHAPTER X.

LEGAL RELATIONS BETWEEN THE CORPORATION AND ITS OFFICERS.

Fiduciary position of corporate officers, §§ 612, 613.	They cannot contract with themselves, § 628.
Liability to pay for qualification shares, § 614.	Secret profits, § 629.
Directors' duties enforceable by the corporation or its receiver. Joinder, § 615.	Transactions fraudulent as a matter of law, § 630.
Liability of directors for fraud, neglect of duty, and acts in violation of by-laws, § 616.	Remedies of the corporation, § 631.
Ordinary care required, §§ 617-619.	Loans by directors to the corporation, §§ 632-634.
Directors not liable for errors of judgment, §§ 620, 621.	Invalidity of transactions in which officers are interested, §§ 635-637.
Liability for <i>ultra vires</i> acts, §§ 622, 623.	Railroad construction companies, §§ 638, 639.
Liability of directors for the acts of other corporate agents, §§ 624-626.	Transactions in which officers act for two adversely interested corporations, §§ 640-644.
Corporate officers should not place their interests in opposition to those of the corporation, § 627.	Directors' authority; their right to indemnification, § 645.
	Compensation of directors and other agents, §§ 646-648.
	Removal of officers, §§ 649, 650.

§ 612. DIRECTORS and other corporate officers and agents occupy towards the corporation which they represent positions of trust and confidence, and owe to it all the duties which persons occupying such positions ordinarily owe to their *cestuïs que trustent*.¹ And the

Fiduciary position of corporate officers.

¹ See *Wardell v. Railroad Co.*, 103 U. S. 651. This proposition can hardly apply when the directors themselves are the only shareholders. Thus, in a recent case, directors issued the entire stock of a corporation to themselves in payment for property transferred to the corporation, and

then sold the stock to innocent outsiders. The issue of the stock was such as was authorized by statute, and the directors at the time of the issue were the only shareholders. It was held that the proceeding could give no cause of action to the corporation. *Foster v. Seymour*, 23 Blatchf. 107.

duties of corporate officers—at least directors—are more complicated than those of ordinary agents of individuals. Primarily they are accountable for the proper performance of their duties to the corporation or body corporate as such. But it must be remembered that the body corporate not only represents the interests of all the shareholders, but is also bound to regard the interests of the creditors of the corporation, whom in a certain sense it also represents; and the directors, of course, are affected with knowledge of the fact that the powers of the body corporate must be exercised with due regard to the interests of all persons in any way interested in the corporate enterprise.

§ 613. The powers of directors are either given them directly by the constitution of the corporation, or delegated to them by the majority of shareholders.¹ It would seem, accordingly, that those powers which directors receive directly from the constitution must be exercised with due regard for the interests of all persons entitled to rely on its provisions, and that the powers which directors receive by vote of a majority of shareholders must also be exercised with due regard for the interests of all, because that majority was bound to exercise *its* powers for the interests of all, and, therefore, only in the interests of all could it delegate power to others. Accordingly, the directors cannot act with blind devotion for the interests of the majority of shareholders,² or even of all the shareholders,³ but must regard at the same time the interests of creditors.⁴ And the truth of this is not affected by the fact that ordinarily in the first instance directors are accountable for the abuse of their powers only to the body corporate; because, as before pointed out, it is to this body as representing all the interests in the corporate enterprise that they are accountable, and if this body fails to enforce the rights of all persons against the directors, the persons injured may themselves take action to bring the directors to account.⁵

Compare Metropolitan Elevated R. R. Co. v. Manhattan Elevated R. R. Co., 11 Daly (N. Y.), 373, 516.

¹ See §§ 219 *et seq.*

² See Goodin v. Cincinnati, etc. Canal Co., 18 Ohio St. 169, § 559.

³ Certain corporate funds, *i. e.*, those

properly applicable to the payment of dividends, may be managed exclusively in the interests of shareholders or paid over to them, and the creditors have no ground to complain. See § 750.

⁴ See §§ 756 *et seq.*

⁵ See §§ 686, 687, 757, 758.

To such an extent may the duties of directors become complicated by the divergency in interest of the different persons to whom they owe duties, that it may often be difficult for them to discriminate properly, and, by giving due and proportionate consideration to the rights of all persons, keep themselves free from liability. It is only by acting always in accordance with the corporate constitution, where that appears silent, using a sound and honest discretion, and in all cases of difficulty taking the advice of counsel, that directors may keep themselves free from liability and carry out the trusts imposed upon them.

§ 614. By accepting the office of director a person impliedly undertakes to discharge its duties, and assumes the liabilities attached to it. Accordingly, where by the constitution of the corporation, the ownership of a certain number of shares is a condition precedent to eligibility as a director, any one accepting the office and acting therein is liable to pay for the requisite number of shares.¹ A person, however, who has merely accepted the office of director, but has not acted as one, and without laches has retracted his acceptance on the ground of misrepresentations made to him by the promoters, will not be held liable as contributory on the qualification shares, if as a matter of fact he has never taken them; for the acceptance of the office of director merely implies an agreement to take the requisite number of shares within a reasonable time after assuming the office.² A director, moreover, is not bound to take the shares directly from the company, but may acquire them by purchase or gift from some prior holder.³

Liability to
pay for
qualifica-
tion shares.

¹ Fowler's Case, L. R. 14 Eq. 316; 226; *In re* Election of St. Lawrence Steamboat Co., 44 N. J. L. 529.

² Karuth's Case, L. R., 20 Eq. 506; see Hewitt's Case, 25 Ch. Div. 283.

³ State v. Leete, 16 Nev. 242; Dent's & Forbe's Case, L. R. 8 Ch.

768; Brown's Case, L. R. 9 Ch. 102; see Chapman's Case, L. R. 2 Eq. 567; Austin's Case, L. R. 2 Eq. 435; Jenner's Case, 7 Ch. D. 132. See also § 578. But see *In re* Carriage Co-operative Supply Ass'n, 27 Ch. Div. 323.

§ 615. Directors' duties are ordinarily enforceable in the name of the corporation;¹ as it is only after failure or neglect on the part of the corporation to enforce the rights which it represents that the creditors or shareholders may themselves proceed to enforce such rights as pertain to them respectively. A receiver, however, or an assignee of the corporation has all the rights and capacities of action possessed by the corporation against its officers.² And in suits against them for damages arising from their negligent or wrongful acts or omissions all the guilty officers may be joined, or any one of them may be sued separately.³

§ 616. In brief, then, the duties of directors and other officers towards the corporation are to act for the furtherance of the complex mass of interests which it possesses or represents, and to do no act infringing the rights of the possessors of any of those interests; these duties include all the duties considered in their correlations and due proportions owed by the directors to any of the classes of persons interested in the corporate enterprise. For the consequences of a breach of this trust on their part, the officers are liable in damages; and first of all, for any fraud or unfair dealing towards the corporation;⁴ then for gross negligence in attending to the corporate affairs, or gross mismanagement whereby the corporate assets are wasted;⁵ and finally for any acts in violation of the by-laws that occasion loss to the corporation.⁶

¹ *Hersey v. Veazie*, 24 Me. 9; *Smith v. Hurd*, 12 Metc. 371.

² *Hun v. Cary*, 82 N. Y. 65; *Shultz v. Christman*, 6 Mo. App. 338; *Austin v. Daniels*, 4 Den. (N. Y.) 299.

³ *Hun v. Cary*, 82 N. Y. 65.

⁴ *First Nat. Bk. v. Reed*, 36 Mich. 263; see *Shultz v. Christman*, 6 Mo. App. 338. If a treasurer misappropriates funds of his corporation and lends them to a third person, an action of contract brought by the corporation against the borrower is not a ratifica-

tion of the treasurer's unauthorized act, and does not discharge him from his liability to the corporation. *Good-year Dental Vulcanite Co. v. Caduc*, 144 Mass. 85.

⁵ *Austin v. Daniels*, 4 Den. (N. Y.) 299; *Citizens' Loan Ass'n v. Lyon*, 29 N. J. Eq. 110. See *Merchants' Bank v. Jeffries*, 21 W. Va. 504.

⁶ *Citizens' Building Ass'n v. Coriell*, 34 N. J. Eq. 383; *Williams v. Riley*, 34 N. J. Eq. 398; *Oakland Bank v. Wilcox*, 60 Cal. 126. An officer, *e. g.*,

§ 617. "The first question to be considered is the measure of fidelity, care, and diligence which such trustees [trustees of a savings bank] owe to such a bank and its depositors. The relation existing between the corporation and its trustees is mainly that of principal and agent, and the relation between the trustees and the depositors is similar to that of trustee and *cestui que trust*. The trustees are bound to observe the limits placed upon their powers in the charter, and if they transcend such limits and cause damage, they incur liability. If they act fraudulently, or do a wilful wrong, it is not doubted that they may be held for all the damage they cause to the bank or its depositors. But if they act in good faith, within the limits of powers conferred, using proper prudence and diligence, they are not responsible for mere mistakes or errors of judgment. That the trustees of such corporations are bound to use some diligence in the discharge of their duties cannot be disputed. All the authorities hold so. What degree of care and diligence are they bound to exercise?¹ Not the highest degree, not such as an extremely vigilant and very careful person would exercise. . . . It would not be proper to answer the question by saying the lowest degree. . . . When one deposits money in a savings bank, or takes stock in a corporation, thus divesting himself of the immediate control of his property, he has the right to expect that the trustees or directors, who are chosen to take his place in the management and control of his property, will exercise ordinary care and prudence in the trusts committed to them—the same degree of care and prudence that men prompted by self-interest generally

Ordinary
care re-
quired.

a cashier, is not liable to the corporation for acts done in good faith, but in violation of a by-law, when the board of directors, who have power to make by-laws and prescribe his duties, practically disregard the by-law which he has violated, and render his observance of it impossible. Thus, where a by-law provided that the cashier should consult a committee of directors in making discounts, he is not liable for neglecting to consult such committee

when, with the acquiescence of the board of directors, it holds no meetings. *Second National Bank v. Burt*, 93 N. Y. 233.

¹ Not keeping property of the corporation insured is not *per se* negligence on the part of directors: the complaint in such a case should allege facts showing that the directors violated their duty in not keeping it insured. *Charleston Boot, etc. v. Dansmore*, 60 N. H. 85.

exercise in their own affairs. When one voluntarily takes the position of trustee or director of a corporation, good faith, exact justice, and public policy unite in requiring of him such a degree of care and prudence, and it is a gross breach of duty—*crassa negligentia*—not to bestow them.”¹

§ 618. Like directors, other corporate officers and agents are bound to observe the utmost good faith towards the corporation; and, perhaps, may be held to even a stricter performance of their duties; for agents and officers, other than directors, usually receive salaries, and are supposed to devote a greater portion of their time to the service of the corporation;² and, generally, all agents and servants of a corporation are bound to act with care and diligence, and, while engaged in the performance of their functions, to act wholly and entirely in its interests.³

§ 619. An admirable exposition of the liability of directors to the corporation for neglect of their duties is contained in a case decided by the greatest of England’s chancellors as long ago as the year 1742. The facts of *Charitable Corporation v. Sutton*⁴ were briefly as follows: The committee-men (directors), into whose hands the general charge of the corporate affairs had been confided, had been guilty either of positive frauds

¹ *Hun v. Cary*, 82 N. Y. 65, 70. Opinion of the court per Earl, J. See *Citizens’ Building Ass’n v. Coriell*, 34 N. J. Eq. 383.

² *Commercial Bank v. Ten Eyck*, 48 N. Y. 305; *Austin v. Daniels*, 4 Den. (N. Y.) 299; *East N. Y.*, etc. R. R. Co. *v.* *Elmore*, 5 Hun, 214; *Pangborn v. Citizens’ Building Ass’n*, 35 N. J. Eq. 341; *First Nat. B’k v. Reed*, 36 Mich. 263. For disobeying an order of court regarding investment of funds of a savings bank, its president may be punished for contempt, though the bank suffer no loss. *Una v. Dodd*, 39 N. J. Eq. 173.

³ A railroad company had a rule that persons not buying tickets before entering should pay ten cents extra. A conductor did not collect this extra

fare, but received the ordinary fare, bought tickets himself, and punched and gave them in, concealing the facts. It was held that this did not constitute a payment, and that the railroad company could, notwithstanding, recover the fares collected by him in assumpsit as money had and received. *Concord R. R. Co. v. Clough*, 49 N. H. 257. Compare *Taylor v. Taylor*, 74 Me. 582. The cashier of a bank, though authorized to loan its funds with or without security, is liable for money loaned without security to an individual, and not entered up for several years; such loan being evidently concealed from the trustees. *San Joaquin Valley Bank v. Bours*, 65 Cal. 247.

⁴ 2 Atkyns, 400.

and breaches of trust, or of gross negligence. The corporation had been formed for the purpose of lending on pledges, and, in contravention of its rules or by-laws, its affairs and the whole power and discretion of lending were left in charge of one or two persons in such a way as to afford them abundant opportunity to defraud the corporation, of which opportunity they took every advantage.

In his opinion, Lord Hardwicke said:¹ "The grounds upon which the plaintiffs found their relief against the committee-men are these: 1. That they have been guilty of manifest breaches of trust, or, at least, of such supine and gross negligence of their duty, and so often repeated, that it will amount to a breach of trust. These are great and important questions. It will be proper to state what are the actual breaches of trust: 1st. Passing of notes, etc. 2dly. Signing notes for loans upon pledges, called renewal pledges, though they knew at the same time that the money originally lent was not paid. 3dly. Signing notes of John Thompson, warehouse-keeper. 4thly. Taking off all checks upon him, etc. 5thly. Making several orders to put it in the power of Thompson, Wooley, and Warren to commit those frauds.

"As to the three first, they are actual breaches of trust, and the committee-men are clearly guilty who have been concerned in them. The by-law prescribes that when notes were to be issued by the cashier, they should be signed by one of the committee-men, and intended as a check upon the warehouse-keeper and cashier. Now several notes have been issued without observing this rule, which is an express contravention of the by-law. . . . As to the third breach of trust, the committee-men's behavior with regard to Thompson, their warehouse-keeper. It is such a notorious fraud, or at least gross inattention to suffer him, who was to set a value upon all the pledges, to borrow money upon them himself, that I shall direct those who shall appear to be guilty of it, to make good the loss.

"As to the fourth and fifth breach of trust, the taking off all checks upon Thompson, and making several orders to put it in

¹ 2 Atkyns, 403 *et seq.*

the power of Thompson, Wooley, and Warren to commit those frauds. These are not so clearly breaches of trust, though at the same time they appear to me to have tended greatly to the loss and prejudice of the corporation. But whether they are criminal will be the question. Now I think the persons present are only liable who issued out the orders, which invested Thompson, Wooley, and Warren with such powers.

“But then another head of charge has been made under the *crassa negligentia*, which has been divided into these several branches: 1st. The committee-men’s non-attendance upon their employment; 2dly. Their not observing the by-law of laying the balance of cash regularly before them; 3dly. Not taking any notice of forfeited pledges; 4thly. Never once inspecting the warehouse to see what number of real pledges were there; 5thly. Putting the whole power into the hands of Thompson, Wooley, and Warren. Now from all these an accumulated charge is made against the whole body of directors or committee-men. Consider first the foundation of this general charge. . . . Committee-men are most properly agents of those who employ them in this trust, and who empower them to direct and superintend the affairs of the corporation. In this respect they may be guilty of acts of commission or omission, of mal-feasance or non-feasance. *Vide* Domat’s Civil Law upon this head (2 B. Tit. 3, §§ 1 and 2). Now where acts are executed within their authority, as repealing by-laws and making orders, in such cases though attended with bad consequences, it will be very difficult to determine that these are breaches of trust. For it is by no means just in a judge, after bad consequences have arisen from such executions of their power, to say that they foresaw at the time what must necessarily happen; and, therefore, were guilty of a breach of trust.

“Next as to mal-feasance and non-feasance. For instance, in non-attendance, if some persons are guilty of gross non-attendance, and leave the management entirely to others, they may be guilty by this means of the breaches of trust that are committed by others. By accepting of a trust of this sort a person is obliged to execute it with fidelity and reasonable diligence; and it is no excuse to say that they had no benefit from it, but that

it was merely honorary; and, therefore, they are within the case of a common trust.¹

“Another objection has been made, that the court can make no decree upon these persons which will be just; for it is said every man’s non-attendance or omission of his duty is his own default, and that each particular person must bear such a proportion as is suitable to the loss arising from his particular neglect, which makes it a case out of the power of this court. Now, if this doctrine should prevail, it is, indeed, *laying the axe at the foot of the tree*. But, if upon inquiry before the master, there should appear to be a supine negligence in all of them, by which a gross complicated loss happens, I will never determine that they are not all guilty. Nor will I ever determine that a court of equity cannot lay hold of every breach of trust, let the person be guilty of it either in a private or public capacity. The tribunals of this kingdom are wisely formed, both of courts of law and equity, and so are the tribunals of most other nations; and for this reason there can be no inquiry but there must be a remedy in all or some of them; and therefore I will never determine that frauds of this kind are out of the reach of courts of law or equity, for an intolerable grievance would follow from such a determination. In the present case one thing is clear [those who were engaged in the confederacy to divert the funds of the corporation], are certainly liable to make good the losses which the corporation have sustained in the first place, and the committee-men who were not partners in this affair are liable in the second place only. Therefore, in the present case, I am of opinion, if there is no evidence, to charge the committee-men of being privy to the original design, yet they will be guilty in the second degree, by conniving at the affair, and not making use of the proper power invested in them by the charter, in order to prevent the ill consequences arising from such a confederacy.”²

§ 620. Directors acting in good faith are not liable, in the absence of gross negligence, for doing what they have been au-

¹ Citing *Coggs v. Bernard*, 1 Salk. Eq. 123; aff’d 41 N. J. Eq. 566; 26. *Williams v. McKay*, 40 N. J. Eq.

² See also *Henry v. Jackson*, 37 Vt. 189.
431; *Wilkinson v. Dodd*, 40 N. J.

thorized to do, even though it was imprudent;¹ nor for errors in judgment in matters within the scope of their discretion, even when the errors seem palpable, and such as men of ordinary prudence would not have committed.² They ordinarily receive no salary,³ are required to exercise only reasonable care and prudence, and cannot be presumed to devote all their time to the service of the company;⁴ and under any circumstances, in the absence of negligence, to hold them liable for the consequences of mere errors of judgment would add an undue hardship to the already onerous responsibilities of their position.

§ 621. The circumstances of a recent Tennessee case are of interest in this connection. The by-laws of a corporation provided that the directors should elect a secretary, whose term of office should be twelve months, or until his successor was elected; and provided further that the secretary should give a bond with sureties for the faithful performance of his duties. The board elected a secretary, took the prescribed bond, and afterwards re-elected the same person for the two following years, but took no new bond, deciding without legal advice and erroneously, though after a discussion of the matter, that the bond already taken was a continuing security. In the third year the secretary became a defaulter, and it was held that the directors having acted in good faith were not liable to make good the loss.⁵

¹ Overend v. Gurney, L. R. 4 Ch. 701; S. C., *sub nom.* Overend and Gurney Co. v. Gibb, L. R. 5 H. L. 480. See International, etc. R. R. Co. v. Bremond, 53 Tex. 96. Directors of a savings bank are not liable for not requiring the president to furnish a bond, when the charter leaves this to their discretion. Williams v. Halliard, 38 N. J. Eq. 373.

² Spring's Appeal, 71 Pa. St. 11; Godbold v. Branch Bank of Mobile, 11 Ala. 191; Citizens' Building Ass'n v. Coriell, 35 N. J. Eq. 383; Hun v. Cary, 82 N. Y. 65, § 617; Charitable Corporation v. Sutton, *supra*; Ex-

celsior Petroleum Co. v. Lacey, 63 N. Y. 422; Vance v. Phoenix Ins. Co., 4 Lea (Tenn.), 385.

³ See § 646.

⁴ Percy v. Millardon, 8 Mart. N. S. (La.) 68.

⁵ Vance v. Phoenix Ins. Co., 4 Lea (Tenn.), 385. Still exception may be taken, perhaps, to this decision. For, did not the directors omit the very precaution which ordinarily prudent men under the circumstances would have taken—a precaution that would have averted the loss—*i. e.*, to consult counsel?

§ 622. If, however, directors do an act even honestly, which is clearly beyond their powers, or *ultra vires* the corporation, they will be liable to the corporation for any damages resulting.¹ As Baron Lindley says:

Liability
for *ultra*
vires acts.

“Directors are responsible for the loss of the company’s assets if that loss is attributable to the employment of the assets in a manner and for purposes not warranted by the constitution.”² Thus, a director of a savings bank, who acts with its president in making a loan on security palpably worth less than double the amount of the loan, and so violates a provision in the charter of the bank, will be liable for any loss.³

§ 623. But it has been held that when the powers of directors are uncertain or difficult to ascertain, and they act honestly under the advice of counsel, they will not be personally liable, even though their acts be afterwards declared beyond their authority and *ultra vires*.⁴ “In regard to whether the defendants [directors] should be held responsible for any of their acts and investments as *ultra vires*, it might be sufficient to notice the fact that the charter of this corporation was a very complicated one, made up by comparing together no less than sixteen acts of incorporation or supplements. . . . To have mistaken

¹ As where directors without authority return deposits to subscribers; *Williams v. Page*, 24 Beav. 654; or cancel subscriptions irregularly and purchase shares (in England) in the stock of the corporation with corporate funds. *Hodgkinson v. National Live Stock Ins. Co.*, 26 Beav. 473; *Joint Stock Discount Co. v. Brown*, L. R. 3 Eq. 139; S. C., L. R. 8 Eq. 381; or, against the provisions of the statute allot shares to infants. *In re Crenver, etc. M’g Co.*, *Ex parte Wilson*, L. R. 8 Ch. 45. See *Lester v. Howard Bank*, 33 Md. 558. Trustees of a savings bank are liable to the receiver for dividends paid by them which were not earned. *Van Dyck v. McQuade*, 45 N. Y. Super. Ct. 620; 2 Lindley on Part., 794; *Evans v. Coventry*, 8 De G. M. & G. 835; see the decree, clause 4. But

see *Excelsior Petroleum Co. v. Lacy*, 63 N. Y. 422. Compare *Turquand v. Marshall*, L. R. 4 Ch. 376; *Stringer’s Case*, L. R. 4 Ch. 475; *Rance’s Case*, L. R. 6 Ch. 104. It is competent for a corporation to release a director from its claims against him on account of an *ultra vires* act of his done on its behalf. *Pneumatic Gas Co. v. Berry*, 113 U. S. 322.

² 2 Lindley on Part., 592. Compare *Pickering v. Stephenson*, L. R. 14 Eq. 322, 342.

³ *Williams v. McDonald*, 42 N. J. Eq. 392.

⁴ *Spering’s Appeal*, 71 Pa. St. 11; *Hodges v. New England Screw Co.*, 1 R. I. 312; S. C., 3 R. I. 9. Compare *Williams v. McDonald*, 37 N. J. Eq. 409.

the extent of their powers under such circumstances would not have been matter of surprise even in the most timid and cautious. We may adopt on this point the language of Green, C. J., in *Hodges v. New England Screw Co.*, 1 R. I. 312: ‘In considering the question of the personal responsibility of the directors we shall assume that they violated the charter of the screw company. The question then will be, Was such violation the result of mistake as to their powers, and if so, did they fall into the mistake from want of proper care, such care as a man of ordinary prudence practices in his own affairs? For if the mistake be such as with proper care might have been avoided, they ought to be liable. If, on the other hand, the mistake be such as the directors might well make, notwithstanding the exercise of proper care, and if they acted in good faith and for the benefit of the Screw Company, they ought not to be liable.’ We may say in this case, conceding that the directors did violate the charter, it was a question upon which with all due care they might have made an honest mistake; and, moreover, it appears by the evidence and is so reported, that they acted throughout by the advice of their counsel. It is well settled that trustees will be protected from responsibility under such circumstances.”¹

Still, it may be suggested that as to transactions within the powers of the corporation, but possibly beyond the powers of the directors, directors may act in safety by procuring beforehand the consent of a majority of shareholders in a corporate meeting; and that as to acts which are *ultra vires*, it may be unwise to permit directors in a great corporation to shield themselves from responsibility behind even the most “unpurchasable opinions” of counsel. The maxim *Ignorantia legis neminem excusat* is one of the pillars of corporation law.

§ 624. As appears from *Charitable Corporation v. Sutton*,² if the directors improperly surrender duties which they ought themselves to perform into the hands of one or more of their number, or into the hands of other agents of the corporation, they may render them-

Liability of
directors
for the acts
of other
corporate
agents.

¹ Spering's Appeal, 71 Pa. St. 11; ² § 619.
opinion of the court per Sharswood,
C. J.

selves liable for damages arising to the corporation from such frauds and wrongful acts as the persons, into whose hands they have improperly surrendered their duties, commit in the performance of them. It is even conceivable that directors, by improperly intrusting to any person discretionary powers confided to them to be exercised only by themselves, might make themselves liable for errors of discretion committed in good faith by that person; even for such errors as the directors would not have been liable for had they themselves committed them in the discharge of their duties. Moreover, if it is the duty of directors to watch over the conduct of each other, and of other agents and clerks of the corporation, and they grossly neglect this duty, they will be liable for the damages arising from wrongful acts which, had it not been for their neglect, the other directors and agents would have been unable to commit.

§ 625. On the other hand, if directors have been guilty of no neglect of duty, they are not responsible for the wrongful acts or omissions of other directors or officers of the corporation; nor for the acts of inferior agents appointed by themselves, provided, in the selection of the last, they have used due care. Directors and other officers are responsible for the performance of their own duties, and cannot be held liable for wrongs which others have committed, unless the commission of such wrongs is in some way due to an omission of duty on their own part.¹

§ 626. The following admirable statement of the liability of directors for the acts of persons other than themselves is taken from Baron Lindley's work on Partnership.² "The most difficult question which arises with reference to the liability of directors is the extent to which each is liable for the acts of the other. The following appear to be the principles applicable to this subject:—

¹ *Batchelor v. Planters' Nat. Bk.*, 78 Ky. 435, 446; *Williams v. Halliard*, 38 N. J. Eq. 373. *In re Denham & Co.*, 25 Ch. D. 752. Unless their liability is extended by statute; see, *e. g.*, *Cons'n of California* 1879, art. xii. § 3. A receiving teller, who knowingly aids

the cashier in abstracting money from the bank, is liable therefor to the bank, though he gets none of the money himself. *Hobart v. Dovell*, 38 N. J. Eq. 553.

² 2 Lindley on Part., 595-596.

"All those directors who are actually implicated in a breach of trust by misapplying the company's money (even although they only sign cheques prepared by others) are jointly and severally liable for the losses arising therefrom.¹

"2. Directors who know of and sanction such a breach of trust are implicated in it within the meaning of this rule, although they do not actively take part in it.²

"3. So are directors who know of the breach of trust, but take no steps to prevent it, beyond writing a letter of disapproval.³

"4. Where the liability is to account for profits improperly received by them, they are only severally liable for their own receipts, and are not jointly and severally liable for each other's receipts.⁴ But it is submitted that their liability is joint and several if there has been a joint receipt by them all, and then a division amongst themselves of what they have all received; or if they have all been implicated in some joint breach of trust resulting in profit to them all.

"5. It has been decided that a director who is not cognizant of a breach of trust committed by his co-directors and who takes no part in it is not liable for it.⁵ This point, however, involves the question whether a director is not bound to make himself acquainted with what his co-directors are doing, and to take such steps as may be in his power to prevent them from doing wrong. On this question opinions differ, and it can

¹ Citing, *Joint Stock Discount Co. v. Brown*, L. R. 8 Eq. 381; *Land Credit Co. v. Fermoy*, L. R. 5 Ch. 768.

² Citing, *Land Credit Co. v. Fermoy*, *supra*.

³ Citing, *Joint Stock Discount Co. v. Brown*, *supra*. The statute of limitations runs against any liability of directors for the wrongful acts of other directors and officers, from the time of the commission of the wrongful acts. *Spering's Appeal*, 71 Pa. St. 11, 25; *Williams v. Halliard*, 38 N. J. Eq. 373.

⁴ Citing, *Parker v. McKenna*, L. R. 10 Ch. 96; *General Exchange Bank v. Horner*, L. R. 9 Eq. 480. If one or more directors improperly dispose of corporate funds they are responsible individually; but to affect them with joint responsibility, it must appear that the act complained of was done by the board or a majority thereof. *Franklin Ins. Co. v. Jenkins*, 8 Wend. 130.

⁵ Citing, *Ashhurst v. Mason*, L. R. 20 Eq. 225. Accord, *Re Montrotier Asphalte Co.*, *Perry's Case*, 34 L. T. N. S. 716.

scarcely be considered as settled. If, indeed (as often happens), the constitution of the company is such as to justify a director in leaving certain matters to his co-directors, or some of them, he is justified in trusting them with such matters, and is not responsible for breaches of trust committed by them and concealed from him. But in other cases his irresponsibility is by no means so clear.

"6. Nor, it seems, is a director liable for breaches of trust committed by his co-directors before he became a director, but afterwards discovered by him. In this case the new director's liability, if any, can only be for the loss sustained by the company by reason of his omission to make known what he has discovered, and to compel the real delinquents to make good their breach of trust; and it is very questionable whether an incoming director is liable in point of law for such omissions."

§ 627. It may be stated as a general rule that directors and other corporate officers should do no acts that are likely to render their personal interests antagonistic to those of the corporation.¹ And when a corporate officer finds his personal interests substantially opposed to those of the corporation, then, not only on account of the rights of the corporation and his duties to it, but also for the sake of his own security, the plainest course for him is to resign.² For, under such circumstances, every step he takes may be subjected to the most searching and harassing investigation at the instance of any person interested in the corporate enterprise, and he will find himself seriously hampered in the assertion of even his honest rights, if such he happen to possess. Thus, for instance, it has been held that

Corporate officers should not place their interests in opposition to those of the corporation.

¹ *Hill v. Frazier*, 22 Pa. St. 320; *Goodin v. Cincinnati, etc. Canal Co.*, 18 Ohio St. 169; § 559, *ante*, ch. 9; *Brewster v. Stratman*, 4 Mo. App. 41; *First Nat. Bk. v. Reed*, 36 Mich. 263. See *In re Imperial Land Co.*, *Ex parte* Larking, 4 Ch. D. 566. Compare *Merrick v. Peru Coal Co.*, 61 Ill. 472.

"Indeed it is not going too far to say that every director of a company is bound, when his personal interests

conflict with his duty to the shareholders, to perform his duty towards them at a sacrifice of his own interest; and a transaction in which a director on behalf of his company has in fact been dealing with himself as an individual cannot stand." 2 *Lindley on Part.*, 590; *Aberdeen R'y Co. v. Blakie*, 1 Macq. 461.

² See *Goodin v. Cincinnati, etc. Canal Co.*, *supra*.

directors of a railroad company cannot acquire an interest in the profits of a contract for the construction of the road, that will give them a standing in a court of equity to interpose an objection to the consummation of a compromise between the railroad company and its contractors.¹ In another instance, where on an execution sale against a corporation, a person who was both its treasurer and a shareholder bought in land held by its trustees, it was held that his title enured to the benefit of the corporation.²

“The affairs of a corporation are generally intrusted to the exclusive management and control of the board of directors; and there is an inherent obligation, implied in the acceptance of such trust, not only that they will use their best efforts to promote the interest of the shareholders, but that they will in no manner use their positions to advance their own individual interest, as distinguished from that of the corporation, or acquire interests that may conflict with the fair and proper discharge of their duty.”³

§ 628. A director or other corporate officer can on behalf of his corporation make with himself no contract that will bind the corporation;⁴ nor any contract in which he is personally in-

¹ *Paine v. Lake Erie, etc. R. R. Co.*, 31 Ind. 283, 353. Compare *Savings Bank v. Wulfekuhler*, 19 Kan. 60. The president of a railroad company who is authorized with two other directors to make a contract for the construction of the road, cannot secretly (at the time of contracting) acquire rights in the contract which he can enforce against the company; and this, whether there be any fraud in fact or not. *Flint and P. M. R'y Co. v. Dewey*, 14 Mich. 477.

² *McAllen v. Woodcock*, 60 Mo. 174; see *Brewster v. Stratman*, 4 Mo. App. 41.

But claims against a corporation do not necessarily become extinguished on being purchased by its agent. The corporation may thereupon become in-

debted to him for money expended in their purchase, provided the purchase was not made in violation of his duties or instructions. *Sullivan v. Triunfo Mining Co.*, 39 Cal. 459; *Seeley v. San José Mill Co.*, 59 Cal. 22; *Merrick v. Peru Coal Co.*, 61 Ill. 472; *Kitchen v. St. Louis, etc. R'y Co.*, 69 Mo. 224. See *Pacific Railroad v. Ketchum*, 101 U. S. 289; also § 633. Compare *Sandy River R. R. Co. v. Stubbs*, 77 Me. 594.

³ *Cumberland Coal, etc. Co. v. Parish*, 42 Md. 598, 605; see *Sellers v. Phoenix Iron Co.*, 13 Fed. Rep. 20.

⁴ *Guild v. Parker*, 43 N. J. L. 430; *Port v. Russell*, 36 Ind. 60; *Coleman v. Second Avenue R. R. Co.*, 38 N. Y. 201; *First National Bank v. Gifford*, 47 Iowa, 575; *First National*

terested.¹ Accordingly, a resolution of the board of trustees of a corporation carried by the casting vote of the president ratifying an unauthorized act of his, in which he was personally interested, is void.² And a board of directors who have bartered away the assets of the corporation for personal gain, cannot, by an act purporting to be an acceptance for the company of an equivalent for such assets, conclude the shareholders or a receiver from showing that no equivalent was actually received.³

They cannot contract with themselves.

§ 629. Corporate officers may not buy from or sell to their corporation and retain any profits from such transactions, unless the profits are known and the transactions acquiesced in by all who could claim any interest in the profits.⁴ For all secret profits derived by them from any dealings in regard to the corporate enterprise they must account to the corporation,⁵ even though the transaction may have benefited it.⁶

Secret profits.

Bank v. Drake, 29 Kansas, 311; *Ex parte Hill*, 32 L. J. Eq. 154; see *Butts v. Wood*, 37 N. Y. 317; *Abbot v. American Hard Rubber Co.*, 33 Barb. 578; *Murray v. Vanderbilt*, 39 Barb. 140; *Munson v. Syracuse*, etc. R'y Co., 29 Hun, 76; *Winchester v. Baltimore*, etc. R. R. Co., 4 Md. 231; compare *Palmer v. Nassau Bank*, 78 Ill. 380.

¹ *European*, etc. R. Co. v. *Poor*, 59 Me. 277; *Blair Town Lot Co. v. Walker*, 50 Iowa, 376.

² *Chamberlain v. Pacific Wool-Growing Co.*, 54 Cal. 103. See *Davis v. Rock Creek L. F. & M. Co.*, 55 Cal. 359; *Bennett v. St. Louis Car*

Roofing Co., 19 Mo. App. 349; *Ward v. Davidson*, 89 Mo. 445.

³ *Guild v. Parker*, 43 N. J. L. 430; see *Rhodes v. Webb*, 24 Minn. 292.

The presumption that directors are acquainted with the affairs of their bank, and that they have notice of all the entries on its books, cannot be relied on by a cashier, seeking to show a ratification of his wrongful appropriation of the moneys of the bank. *First National Bank v. Drake*, 29 Kans. 311.

⁴ See *Imperial Mercantile Credit Association v. Coleman*, L. R. 6 H. L. 189.

⁵ *European*, etc. R'y Co. v. *Poor*,

⁶ *Bent v. Priest*, 10 Mo. App. 543. An officer of a corporation may act as trustee for bondholders under a mortgage made by it. *Ellis v. Boston*, etc. R. R. Co., 107 Mass. 1. But in *Ashuelot R. R. v. Elliot*, 57 N. H.

397, the treasurer of a corporation, who was also trustee for bondholders, was held to account to the railroad company for profits made by him while in possession as trustee under the mortgage.

Thus, where the directors of a ferry company bought a steamboat in their individual capacity, and so owning it bought it of themselves for the company at a large advance, it was held that the transaction was fraudulent, and that their profits enured to the benefit of the company, who might recover them with interest.¹ In another case the treasurer of a bank had received authority from it to sell certain of its property, which he thereupon sold to himself and some of his brother officers at the minimum price he was authorized to sell at; which was far below the market value of the property. The bank was allowed to recover of him the difference between the market value and the price at which he had sold to himself.² And when suit is brought against directors to compel them to account for the profits of transactions wherein they have acted on behalf of the corporation, they cannot plead that the transactions were *ultra vires* the corporation.³

59 Me. 277; *Parker v. Nickerson*, 112 Mass. 195; *Bent v. Priest*, 86 Mo. 475; *Ward v. Davidson*, 89 Mo. 445.

Compare *Hazard v. Durant*, 14 R. I. 25.

Directors cannot speculate with corporate funds or credit and appropriate the profit. *Redmond v. Dickerson*, 9 N. J. Eq. 507. Directors of a bank must give up to it all secret profits received by them as a bonus to obtain a loan from it. *Farmers', etc. Bank v. Downey*, 53 Cal. 466. See also *York, etc. R. R. Co. v. Hudson*, 16 Beav. 485; *Parker v. McKenna*, L. R. 10 Ch. 96; *Dunston v. Imperial Gas Co.*, 3 Barn. & Adol. 125; *General Exchange Bank v. Horner*, L. R. 9 Eq. 580; *Gaskell v. Chambers*, 26 Beav. 360; *Madrid Bank v. Pelly*, L. R. 7 Eq. 442; 2 *Lindley on Part.*, 588-589.

¹ *Parker v. Nickerson*, 112 Mass. 195.

² *Greenfield Savings Bank v. Simons*, 133 Mass. 415.

³ See *Hill v. Nisbet*, 100 Ind. 341. Compare §§ 280-282, where it is shown that even when affected with no estoppel an outsider can take no advantage of the fact that a given transaction was *ultra vires* a corporation. Similarly it is only the corporation, and its shareholders and creditors, that can avail of the fact that its officers were secretly interested in matters wherein they acted for the corporation, or, as its agents, dealt with themselves. In a recent case in Iowa, trustees holding lands in trust for a railroad company conveyed some of the lands, under authority of the board of directors, to be reconveyed to themselves in payment for their services. It was held that a person claiming such lands under a title adverse to that of the railroad company could not dispute the validity of this conveyance. *Miller v. Iowa Land Co.*, 56 Iowa, 374.

§ 630. Transactions like the foregoing are fraudulent as a matter of law, and no fraud or unfair dealing need be proved as matters of fact by the corporation in order to set them aside, or compel the officers implicated to account for the profits they have made.¹ It has been held that an express contract between directors and the corporation is voidable at the option of the latter, acting within a reasonable time; and that no consideration of the fairness of the contract will induce a court of law or equity to enforce it against the resisting *cestui que trust*, though as to others it may be valid.² But such contracts may be ratified by the corporation either expressly, or by acquiescence for a long period and the acceptance of the benefits of the transactions:³ provided the ratification or acquiescence on the part of a corporation is free and voluntary, and not that of a man whose hands are tied.

Transac-
tions
fraudulent
as a matter
of law.

In *Pacific Railroad of Missouri v. Missouri Pacific Railway Company*,⁴ a foreclosure was brought against a railroad company, and a decree of sale entered, practically by its consent, its answer having admitted the allegations of the bill. It then appealed from the decree, and tried to bring before the Federal Supreme Court on appeal facts showing that its directors and its solicitor had acted fraudulently and in hostility to its interests in allowing the decree to be taken. The corporate

¹ *Greenfield Savings Bank v. Simons*, 133 Mass. 415; *Bent v. Priest*, 10 Mo. App. 543; *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. L. 505; *Cook v. Berlin Woollen Mill Co.*, 43 Wis. 433; *Duncomb v. New York, H. & N. R. R. Co.*, 84 N. Y. 190; compare *Davoue v. Fanning*, 2 Johns. Ch. 252. Although there be no actual fraud or unfairness, a corporation may repudiate a contract entered into by its board of directors, when one of them is interested on the other side, and the corporation need not show that the influence of such director determined the action of the board. *Munson v. Syracuse, etc. R. R. Co.*, 103 N. Y. 58.

See *Aberdeen Ry. Co. v. Blakie*, 2 (H. L.) Eq. 1281.

² *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. L. 505. See also *Little Rock and Fort Smith R'y Co. v. Page*, 35 Ark. 304. A station agent bargained with his company for an excursion train, not letting it be known that he wanted it for himself. *Held*, the company on discovering this could disaffirm the contract. *Pegram v. Charlotte, etc. R. R. Co.*, 84 N. C. 696.

³ *Kelley v. Newburyport Horse R. R.*, 141 Mass. 496; *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587, § 632; *Town of Searcy v. Yarnell*, 47 Ark. 269.

⁴ 111 U. S. 505.

management seems to have been changed shortly after the entry of the decree. The appeal duly prosecuted was not decided for about three years. The appellate court found no error which it could correct on appeal, but intimated that a remedy could be had in the court below.¹ As soon as possible after the appeal was decided, suit was brought to set aside the decree. The defendants demurred on the ground of laches; but it was held, and sustained on appeal, that the time during which the appeal was pending should not be counted against the plaintiff. Giving the opinion of the court, Justice Blatchford said: "As to the frauds alleged in the bill respecting the matters in the conduct of the suit, resulting in the decree, the right to relief is based on the view, that the corporation itself, the present plaintiff, speaking and acting now for its stockholders as a body, was powerless then, because it was misrepresented by unfaithful directors, who did what was done and refused to do otherwise, and through whom alone it could then speak and act. . . . Under such circumstances mere knowledge by or notice to the plaintiff, or its directors or officers, or more or less of its stockholders, is unimportant; and the plaintiff cannot be concluded by the failure of any number of its stockholders to do, what unfaithful directors ought to have done, unless a case is shown of such acquiescence, assent or ratification as would make it inequitable to permit what has been done to be set aside, or unless the rights of innocent purchasers have subsequently intervened, to an extent creating an equitable bar to the granting of relief. The bill in this case does not show such a state of things. While stockholders, more or less in number, may be allowed to interpose, if they have the means or the inclination to take upon themselves the burden of such gigantic controversies as are involved in the railroad transactions of the present day, it would go far to legalize condonation of such transactions as are set forth in the bill, if mere knowledge by helpless stockholders of the fraudulent acts of their directors were to prevent the corporation itself from seeking redress, if it act promptly when freed from the control of such directors. Frequently requesting unfaithful directors to resign and employ other counsel,

¹ Reported as *Pacific R. R. Co. v. Ketcham*, 101 U. S. 289.

so far from throwing on the stockholders the peril of losing their rights, represented by the company, if they do not personally assert them in place of the directors, operates of itself, without more, only to aggravate the wrong. At the same time it by no means follows that parties who have become interested in the plaintiff's corporation with knowledge of matters set forth in the bill, are entitled to the same standing as to relief with those who were interested in the corporation when the transactions complained of occurred."¹

§ 631. Accordingly, when corporate officers have been guilty of a breach of trust towards the corporation, the latter may disaffirm the transaction, provided the rights of innocent outsiders do not intervene, and may hold the officers liable for damages;² or without disaffirming the transaction, may compel the officers to account, with interest, for any profits they have made.³ The corporation cannot, however, adopt in part and in part repudiate an improper transaction of its officers.⁴ And the right of a corporation to avoid a transaction on account of the fiduciary relations sustained towards it by the other party, must be exercised within a reasonable time after the facts connected therewith are known or could by due diligence have been ascertained.⁵

Remedies
of the cor-
poration.

§ 632. Of course, directors are not excluded from deriving profit from the corporate enterprise which is shared by the (other) shareholders; as, for instance, they may receive their proportion of dividends. Directors may also loan money to the corporation if the terms

Loans by
directors to
the cor-
poration.

¹ *Pacific R. R. of Missouri v. Pacific R'y. Co.*, 111 U. S. 505, 520. Compare *Graham v. Boston, etc. R. R. Co.*, 118 U. S. 162.

² *Ryan v. Leavenworth, etc. R'y Co.*, 21 Kan. 365. See also cases in last note but two. The receiver may sue. *Curtis v. Leavitt*, 15 N. Y. 10, 44. See *High on Receivers*, § 316 and § 615.

³ *Parker v. Nickerson*, 112 Mass. 195; *S. C.*, 137 Mass. 487; *Greenfield Savings Bank v. Simons*, 133

Mass. 415 (*supra*, § 629); *Gaskell v. Chambers*, 26 Beav. 360; *York, etc. R'y Co. v. Hudson*, 16 Beav. 485; *Madrid Bank v. Pelly*, L. R. 7 Eq. 442; *Parker v. McKenna*, L. R. 10 Ch. 96; *Buffalo, N. Y. and Erie R. Co. v. Lampson*, 47 Barb. 533.

⁴ *Great Luxembourg R'y Co. v. Magnay*, 25 Beav. 586; *Second National Bank v. Burt*, 93 N. Y. 233.

⁵ *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587. See *Stewart v. Lehigh Valley R. R. Co.*, 38 N. J. L. 525.

are as favorable to the corporation as the most favorable terms on which the directors could borrow money for it from outsiders.¹

Thus, in *Twin-Lick Oil Co. v. Marbury*,² the Federal Supreme Court held that there was no rule forbidding one director among several from loaning money to the corporation, if the money is needed and the transaction is open and otherwise free from blame; and that he might purchase its property at a fair public sale, made by a trustee under a deed of trust executed to secure the payment of his debt. The property in controversy was oil land of a fluctuating value; the director committed no actual fraud; and at the time of the sale the shareholders knew all the facts, and refused to join him either in the purchase or in paying assessments on their shares. It was held, that four years afterwards, when by his skill and energy he had made the property profitable, the corporation could not have the sale set aside or an accounting for profits.³

§ 633. The facts of another important case were as follows: A., who at the time was the president of a railroad company, but not a shareholder, made advances to it in perfect good faith of eighty-one thousand dollars to aid it in constructing its road. At a meeting of the executive committee of the board, consisting of himself and two other directors, who were guarantors on a note to him for a portion of his claim, a resolution was passed directing the treasurer to deliver to him eight hundred and ten thousand dollars of its bonds as collateral security. This action the board subsequently sanctioned. The company afterwards became insolvent; the trustee for the bondholders brought suit to foreclose the mortgage given to secure the bonds; and on appeal taken from an order entered in the suit, determining the relative rights and priorities of certain of the bondholders, A. was allowed to prove his bonds to the full amount, and share in the distribution of the assets of the company to the extent of

¹ *Campbell's Case*, 4 Ch. D. 470; 701, 720; *Harts v. Brown*, 77 Ill. 226. *Santa Cruz R. R. Co. v. Spreckles*, 65 Cal. 193; *Sutter St. R. R. Co. v. Baum*, 66 Cal. 44. See *Seely v. San José Mill Co.*, 59 Cal. 22; *Humphrey v. Patrons Mercantile Assn.*, 50 Iowa, 607; *Hill v. Nisbet*, 100 Ind. 341; *Lusk's Appeal*, 108 Pa. St. 152.

² 91 U. S. 587.

³ *Accord*, *Addison v. Lewis*, 75 Va.

its real indebtedness to him.¹ On a former appeal of the same case, Judge Finch said: "Where the trustee's act consists, not in possessing himself of the property of the beneficiary as owner, but in taking collateral security for a debt honestly due him or a liability justly incurred, the rule [that the beneficiary may as of course avoid the contract] can have no application, since the payment of the debt or the discharge of the liability is an essential prerequisite of the avoidance. And this is true whether the pledge is taken for a present or precedent debt."²

Nevertheless, in the appeal, from which the preceding citation is taken, it is said that as a general rule a director buys corporate bonds below par only at the peril of their avoidance by the courts at the suit of the corporation.³ Yet it has been held that the treasurer of a corporation may with his own money purchase its notes at a discount and collect their face value from the corporation, provided that at the time of the purchase he was under no duty to the corporation to purchase or pay the notes in its behalf.⁴ But it has also been held that directors cannot, when the corporation is insolvent, buy up

¹ *Duncomb v. New York, H. and N. R. R. Co.*, 88 N. Y. 1.

² *Duncomb v. New York, H. and N. R. R. Co.*, 84 N. Y. 190, 199. See also *Budd v. Walla Walla Printing Co.*, 2 Wash. Ter. 347; *Harpending v. Munson*, 91 N. Y. 650. The language here of the learned judge, perhaps, is somewhat broad. The money loaned may indeed have been advanced in good faith for the benefit of the corporation; but under some circumstances, to force the corporation to pay its debt before demanding back its security, might be very oppressive. In the case in the text, the court laid stress on the fact that the security taken was not under the circumstances excessive; and that the corporation was not insolvent at the time it was taken. Compare *Hope v. Valley City Salt Co.*, 25 W. Va. 789.

³ *Duncomb v. New York, H. and N. R. R. Co.*, 84 N. Y. 190. If a director, by agreement with his co-directors, take, directly from his company, its bonds below par on his private account and sell them at an advance; he may be compelled to account for the profits for the benefit of the corporation, its shareholders, or creditors; and this although he acted in good faith. *Widrig v. Newport Street Ry. Co.*, 82 Ky. 511. But when suit is brought to foreclose a mortgage made to secure bonds issued to directors, they will not be declared void at the instance of a subsequent lienor, when the corporation does not defend. *Bassett v. Monte Christo M. Co.*, 15 Nev. 293.

⁴ *St. Louis, etc. R. R. Co. v. Waller*, 36 Kan. 51.

claims against it at a discount, and then prove them at their face on the winding up of the corporation.¹

§ 634. The following rules regarding loans to a corporation from its officers seem deducible from the preceding and other cases. Directors or other officers may, when they honestly deem it for the interest of the corporation to borrow,² advance it money on terms as favorable as any on which they could have procured the money for it from other sources; and they may take from the corporation security for their loan.³ But they cannot—at least when the corporation is insolvent—take advantage of their inside position to secure their existing debts to the injury of other creditors of the corporation;⁴ and no more in recovering their debts or enforcing their security than in the original transaction of loaning the money, can they disregard the interests of the corporation.⁵ Under such circumstances not only may they not avail themselves of their control over the affairs of the corporation to oppress it, but they cannot make unconditional and unrestricted use of legal means open to outside creditors.⁶

§ 635. Exceedingly difficult and complicated questions arise in regard to transactions in which corporate officers, while personally interested adversely to their corporation, contract on its behalf with outsiders, whose interests in the transaction may be the same as the personal interests of the contracting officers;

¹ *Lingle v. Nat. Ins. Co.*, 45 Mo. (Super. Ct. of Iowa), 21 Am. Law 109; *In re Imperial Land Co.*, *Ex Reg. N. S.* 443.

parte Larking, 4 Ch. D. 566; *Patrick v. Boonville Gas Light Co.*, 17 Mo. App. 462. See § 759. Compare *Inglehart v. Thousand Islands Hotel Co.*, 32 Hun (N. Y.), 377.

² See *Harts v. Brown*, 77 Ill. 226.

³ But if the terms of the loan, the rate of interest and security taken, are oppressive or exorbitant, they may be disaffirmed by the corporation and set aside on repayment of the amount loaned with legal interest. *Sutter Street R. R. Co. v. Baum*, 66 Cal. 44.

⁴ See § 759.

⁵ *Hallam v. Indianola Hotel Co.*

⁶ See *Hallam v. Indianola Hotel Co.*, *supra*. In matters in no way relating to his official position, however, a director may sue a corporation just as a shareholder or any other person having a cause of action against it. *Burbank v. West Walker Ditch Co.*, 13 Nev. 481. And it has been held that a Director can plead to a recovery of interest on a loan from his bank to himself, that the interest was agreed on in contravention of the National Banking Act. *Bank v. Slemmons*, 34 Ohio St. 142; compare *Lester v. Howard Bk.*, 33 Md. 558.

and also in regard to transactions in which the same officers act for two adversely interested corporations.

§ 636. Every person, even though he act in good faith, is affected with notice of the general rule of law that an officer cannot bind his corporation by a contract in which he is personally interested. Thus, a general authority to a bank president to certify checks drawn on it, does not extend to checks drawn by himself. Invalidity of transactions in which the officers are interested. Consequently, the face of the check showing the president's attempt to use his official character for his private interest, every one taking it is put on his inquiry; and when the certification is false, no one can, as a *bona fide* holder of the check, recover against the bank on the certification.¹

Accordingly, the first question will ordinarily be, did the person contracting with the corporation through its officers, know, or have reason to know, that in the same transaction the officers were personally interested in a way that might lead them to regard their own interests rather than those of the corporation? If this be answered in the negative, and the other contracting parties acted in good faith, they will be protected, having acted on the reasonable assumption that the corporate officers were not violating their duty.²

§ 637. In many cases of this nature, however, that have come before the courts, the outside parties have occupied no such favorable and honest position; but have acted with their eyes only too open, and often have actively combined with the officers to defraud the corporation. Under such circumstances, they will be liable to account to the corporation equally with its guilty officers.³

¹ *Claffin v. Farmers and Citizens' Bk.*, 25 N. Y. 293. See also *West St. Louis Bank v. Shawnee County Bank*, 95 U. S. 557; *McKee v. Grand Rapids, etc. Ry. Co.*, 41 Mich. 274.

² *Genesee Savings Bank v. Michigan Barge Co.*, 52 Mich. 438. See § 204.

³ *Ryan v. Leavenworth, etc. R'y Co.*, 21 Kan. 365; see also *Kersey Oil Co. v. Oil Creek, etc. R. R. Co.*, 12 Phila. (Pa.) 374.

When a board of mining directors lease a mine to a party acting in the interests of the minority of shareholders, in order to withdraw it from the control of a board about to be elected, and thereby perpetuate the control of the minority, the corporation may set the lease aside by a bill in equity. *Mahany Mining Co. v. Bennett*, 5 Sawyer, 141. A court of equity, however, will not set aside

Thus, in an English case, the plaintiff, a stock company, made with the defendant, also a stock company, a contract which gave the plaintiff the option of having a telegraph cable manufactured and laid by the defendant; the cable to be paid for in instalments, payable, after the first, as the work was certified to by the plaintiff's engineer. The option was exercised, and the first instalment paid to the defendant, the plaintiff also paying a commission to its own engineer. It then discovered that its engineer had a secret sub-contract with the defendant company to lay the cable himself. The court held the plaintiff entitled to have the contract set aside, and the instalment and commission returned to it.¹

§ 638. In the United States it is not uncommon for the directors of a railroad company, whose road is in process of construction, to join with other persons in forming a construction company; and then, on behalf of their railroad, make contracts with the construction company most favorable to the latter and themselves. Such dishonest transactions the courts will set aside, and by compelling accountings for profits, or awarding damages against the guilty directors, restore, as far as possible, the railroad company to its property and rights.² Under such circumstances, it is not necessary for the railroad corporation to prove actual fraud, or that the transaction was against its interest.³

§ 639. *Wardell v. Railroad Co.*⁴ is a leading and instructive case in connection with this subject. There the president of the Union Pacific Railroad, by order of the executive committee of the board of directors, entered into a contract to allow

these improper contracts at the suit of parties (shareholders and directors) to them. *Weed v. Little Falls, etc. R. Co.*, 31 Minn. 154. *v. Brownsville, etc. R'y Co.*, 1 McCrary, 392. See *Abbot v. American Hard Rubber Co.*, 33 Barb. 578.

¹ *Panama, etc. Telegraph Co. v. India Rubber, etc. Telegraph Works Co.*, 32 L. T. N. S. 517. ³ *Gillman, etc. R. R. Co. v. Kelly*, 77 Ill. 426. Compare *Union Pac. R. Co. v. Credit Mobilier*, 135 Mass. 367.

² *Ryan v. Leavenworth, etc. R'y Co.*, 21 Kan. 365; *Gilman, etc. R. R. Co. v. Kelly*, 77 Ill. 426; *Wardell v. Railroad Co.*, 103 U. S. 651; *Thomas* ⁴ 103 U. S. 651. See also *Union Pacific R. R. Co. v. Credit Mobilier*, 135 Mass. 367, 376.

one Wardell and another to work coal lands belonging to the company, agreeing that the railroad company would purchase coal of them for fifteen years at prices which secured them high profits. Thereupon a coal company was formed, in which six of the railroad directors owned a majority of stock, and, in pursuance of a previous secret arrangement, the contract was assigned to it without consideration. The court held the contract a fraud on the railroad company, and that Wardell could sustain no claim against that company for its repudiation of the contract. "All arrangements by directors of a railroad company, to secure an undue advantage at its expense, by the formation of a new company as auxiliary to the original one, with an understanding that they, or some of them, shall take stock in it, and then that valuable contracts shall be given it, in the profits of which they, as stockholders of the new company, are to share, are so many unlawful devices to enrich themselves to the detriment of the stockholders and creditors of the original company, and will be condemned whenever properly brought before the courts for consideration."¹

§ 640. The class of cases just discussed must carefully be distinguished—and this in practice will often be most difficult—from cases which have arisen concerning contracts between two corporations, the validity of which is contested on the ground that some of the officers of one corporation are officers of the other.

Transactions in which officers act for two adversely interested corporations.

These latter contracts may be set aside on the

¹ Wardell v. Railroad Co., 103 U. S. 651, 658. Opinion of the court per Justice Field. In a later case in the Federal Supreme Court, the directors of a railroad had made a contract, in which two of them were personally interested, for the construction of the road, and had issued the bonds of the company to the contractors; suit was brought to foreclose the mortgage made to secure the bonds, and the corporation allowed judgment to be taken against it by default. Thereupon certain shareholders intervened, and the court held that the contract could not be en-

forced, nor the bonds either, which had not come into the hands of innocent holders for value. But the court also held that the shareholders seeking equity must do equity, and that the bondholders were entitled to be reimbursed the sums which they had actually expended, and to be paid the fair value of their services and materials furnished; this value, however, not to be estimated by the prices mentioned in the contract. Thomas v. Brownville, etc. R. R. Co., 109 U. S. 522.

ground of fraud like other contracts,¹ and to say that they are especially open to the suspicion that one corporation has been unfavorably favored at the expense of the other, is perhaps not going too far. Moreover, a contract of this character is voidable if the common officers making it have personal interests in the transaction which decidedly lead them to favor one rather than the other of the contracting parties.² But in such case the contract would be set aside, not on the ground that a common agent represented two principals, but because it is a contract in which he was personally interested.

§ 641. Another preliminary consideration to be borne carefully in mind is that the acts and declarations of the agent while acting as the agent of one of the corporations can create, at least in favor of that corporation, no estoppel binding on the other corporation, whom he may also represent.³ Likewise, that the two companies have some common directors or a common solicitor, does not affect one company with notice of acts done or knowledge possessed by the common directors or solicitor as directors or solicitor of the other company.⁴

§ 642. It may be asserted with nearly as much safety as will attend the assertion of any exceedingly general negative legal proposition, that there is no rule of law preventing an agent from representing and binding two adverse principals in the same transaction. For instance, the same person acting as broker may bind both buyer and seller by a bought and sold note,⁵ and at auctions the auctioneer may be the agent of both parties.⁶ There is no presumption that the common agent of two adverse principals will act unfairly towards either.⁷

¹ See, especially on this point, *Goodin v. Cincinnati, etc. Canal Co.*, 18 Ohio St. 169, cited at length in § 559.

² *Gallery v. Nat. Exchange Bk.*, 41 Mich. 169. Compare *San Diego v. San Diego, etc. R. R. Co.*, 44 Cal. 106.

³ *Pennsylvania R. R. Co.'s Appeal*, 80 Pa. St. 265. In such cases it may be often difficult to determine for whom the agent was acting when he made the declaration, but it is safe to assume that under such circumstances no court would favor an estoppel.

⁴ *In re Marseilles Extension R'y Co.*, 20 W. R. 254; *DeKay v. Hackensack Water Co.*, 38 N. J. Eq. 158. Compare *Kersey Oil Co. v. Oil Creek, etc. R. R. Co.*, 12 Phila. (Pa.) 374; see also § 210.

⁵ *Butler v. Thomson*, 92 U. S. 412.

⁶ *Pugh v. Chesseldine*, 11 Ohio, 109, 123.

⁷ *Adams Mfg. Co. v. Senter*, 26 Mich. 73; *Booth v. Robinson*, 55 Md. 419. See *Clark v. Trust Co.*, 100 U. S. 149.

Accordingly, one agent may validly act for two adversely interested corporations in the same transaction, provided there is no improper concealment of the double agency.¹ On behalf of one company he may sell, and on behalf of the other buy the same property.² And it has been expressly decided in more than one state after full consideration, that a contract between two corporations, made by their respective boards of directors, is not invalidated or rendered voidable at the election of one of the parties thereto, from the mere circumstance that a minority of its board of directors are also directors of the other company.³

§ 643. In *United States Rolling Stock Co. v. Atlantic and Gt. Western R. R. Co.*, it was said by Judge Boynton, giving the opinion of the Supreme Court of Ohio:⁴ "We have not, upon the most diligent research, been able to find a case holding a contract made between two corporations by their respective boards of directors invalid, or voidable at the election of one of the parties thereto, from the mere circumstance that a minority of its board of directors are also directors of the other company, nor do we think such a rule ought to be adopted. There is no just reason, where a quorum of directors, sustaining no relation of trust or duty to the other corporation, are present participating in the action of the board, why such action should not be binding upon the company, in the absence of such fraud as would lead a court of equity to undo or set aside the transaction. If the mere fact that a minority of one

¹ *Bradley v. Richardson*, 23 Vt. 720; *Chicago and N. W. R. R. Co. v. Northern Line Packet Co.*, 70 Ill. 217.

² *Adams Mining Co. v. Senter*, 26 Mich. 73. But see *San Diego v. San Diego*, etc. R. R. Co., 44 Cal. 106; *Memphis K. and C. R. R. Co. v. Parsons Town Co.*, 26 Kan. 503, 509.

³ *United States Rolling Stock Co. v. Atlantic and Gt. Western R. R. Co.*, 34 Ohio St. 450; *Mayor*, etc. of *Griffin v. Inman*, 57 Ga. 370; see also *Booth v. Robinson*, 55 Md. 419; *Union Pacific R. R. Co. v. Credit Mobilier*,

135 Mass. 367, 377; *Wallace v. Long Island R. R. Co.*, 12 Hun (N. Y.), 460. Accord, *Foster v. Oxford*, etc. Ry. Co., 13 C. B. 200, 203. But see, *semble*, contra, *San Diego v. San Diego*, etc. R. R. Co., 44 Cal. 106, a case in which, it seems to the writer, the personal interests of the common agent decidedly leaned towards one of his adversely interested principals; also *Bill v. Western Un. Tel. Co.*, 16 Fed. Rep. 14; *Ashuelot R. R. Co. v. Elliot*, 57 N. H. 397.

⁴ 34 Ohio St. 450, 466.

board are members of the other gives the company an option to avoid the contract without respect to its fairness, the same result would follow where such minority consisted of but one person, and notwithstanding the board might consist of twenty or more. In our judgment, where a majority of the board are not adversely interested, and have no adverse employment, the right to avoid the contract or transaction does not exist without proof of fraud or unfairness; and hence the fact that five of the defendant's board of directors were members of the plaintiff's board, whatever may have been its effect on the defendant's right to disaffirm or repudiate the contract, if exercised within a reasonable time, did not disable the defendant from subsequently affirming the contract if satisfied with its terms, or rejecting it if not, nor did it relieve it from the duty to exercise its election to avoid or rescind within a reasonable time, if not willing to abide by its terms."

§ 644. It will be noticed that the cases last referred to are hardly authority for the proposition, that it is competent for respective boards of directors to bind adversely interested corporations in the same transactions, when a majority of each board are members of both boards. But there is no authority against this if the contract is in other respects free from suspicion.¹ Still, under such circumstances, it would be advisable for the directors to procure a ratification of their action from duly summoned meetings of the respective bodies of shareholders, before whom all the circumstances of the transaction should be laid bare.

§ 645. So far the discussion has been of the duties of directors.

Directors'
authority;
their right
to indemnifi-
cation.

They have, however, certain rights: and, in the first place, the right or authority, within the scope of their discretionary powers, to manage the corporate affairs in accordance with their sound discretion, exempt from any interference, except perhaps the controlling action of a majority of shareholders in a corporate meeting.²

¹ *Goodin v. Cincinnati, etc. Canal Tel. Co.*, 16 Fed. Rep. 14; and compare *Wallace v. Long Island R. R. Co.*, 12 Hun (N. Y.), 460.
² See *Railway Co. v. Alling*, 99 U. S. 463; *Elkins v. Camden, etc. R. R.*

Further, they have a right to be indemnified by the corporation from any personal liability which may attach to them by reason of proper acts on their part; or which they may have with propriety assumed on its behalf while acting within their authority.¹ The English courts have gone further. In *Ex parte Chippendale*² it was decided that when directors who had no authority to borrow money on behalf of the company did in fact borrow money and make advances themselves in good faith, and apply it all to the benefit of the company, they were entitled, having themselves repaid the money borrowed, to be reimbursed by the shareholders the whole amount borrowed and advanced. The equities of the directors were very strong in this case; the money was urgently needed to prevent great loss to the company, and the shareholders were kept informed of the transactions. This decision, however, was used as a precedent in cases going beyond it,³ till the danger of extending its principles was recognized by the courts, and their application restricted to cases where money had been applied to the discharge of debts for which the company was liable.⁴ It is obvious that any extension of the doctrine of *Ex parte Chippendale* is incompatible with the security of persons interested in the corporate funds; for the liability of these funds to the directors for moneys expended or liability assumed by them would thereby become measured not by the authority which the directors had received, but only by their discretion. It is

Co., 36 N. J. Eq. 241; § 684. When the management of the business is by statute confided to the directors, the corporation cannot by a vote join another officer who is not a director with them, or compel them to act with him in managing its business. *Charleston Boot, etc. Co. v. Dunsmore*, 60 N. H. 85.

¹ See *In re Court Grange Mg. Co. Ex parte Sedgwick*, 2 Jur. N. S. 494. "As members they [directors] are entitled to contribution in respect of such debts and liabilities of the company as they may be compellable or have been compelled to pay; and as agents and

trustees they are entitled to be indemnified by the company from all losses and expenses *bona fide* sustained and incurred by them in the exercise of the trust imposed on them." 2 Lindley on Part. 760.

² 4 De G. M. & G. 19.

³ See *In re Norwich Yarn Co., Ex parte Bignold*, 22 Beav. 143; *In re Nat. Patent Fuel Co., Baker's Case*, 1 Dr. & Sm. 54; *Troup's Case*, 29 Beav. 353; *Hoare's Case*, 30 Beav. 225.

⁴ See *In re Natl. Bldg. Soc'y, Ex parte Williamson*, L. R. 5 Ch. 309.

certainly safer to adhere to the "sensible rule that agents are not entitled to any indemnity from their principals in respect of unauthorized expenditures."¹

§ 646. In the absence of some express provision in the constitution or by-laws of the corporation, a director is not entitled to any compensation for his official services.² He cannot recover on a *quantum meruit* for his services as director;³ and, moreover, to entitle him to compensation, the by-law or resolution providing for his compensation must have been passed before his services as director were rendered.⁴ Because a subsequent vote to pay a director for his official services is without consideration, and he cannot recover on it against the corporation.⁵

§ 647. Neither can a president recover for his services as such except under the same circumstances and conditions as an ordinary director.⁶ But a director, or a president, who renders services outside of the scope of his regular duties, may, accord-

¹ 2 Lindley on Part. 765; where (pp. 760-768) will be found an interesting discussion of these cases. See also *In re Worcester Corn Exchange Co.*, 3 De G. M. & G. 180; *Ex parte Cropper*, 1 De G. M. & G. 147.

² *Illinois Linen Co. v. Hough*, 91 Ill. 63; *American Central R'y Co. v. Miles*, 52 Ill. 174; *Maux Ferry Gravel Road Co. v. Branegan*, 40 Ind. 361; *Smith v. Putnam*, 61 N. H. 632.

³ *Citizens' Nat. B'k v. Elliott*, 55 Iowa, 104; see cases in preceding note.

⁴ *Lafayette, etc. R'y Co. v. Chee-ney*, 87 Ill. 446; S. C., 68 Ill. 570. Compare *Barstow v. City R. R. Co.*, 42 Cal. 465.

⁵ *Loan Ass'n v. Stonemetz*, 29 Pa. St. 534; see *Carr v. Chartiers Coal Co.*, 25 Pa. St. 337. Directors cannot make themselves allowances for their services. *Maux Ferry Gravel Road Co. v. Branegan*, 40 Ind. 361; *Gardner v. Butler*, 30 N. J. Eq. 702, 721; *Blatchford v. Rose*, 54 Barb. 42;

Jones v. Morrison, 31 Minn. 140; see *Butts v. Wood*, 37 N. Y. 317. Directors cannot fix their own salaries as president, secretary, etc. *Kelsey v. Sargent*, 40 Hun (N. Y.), 150; *Bennett v. St. Louis Car Roofing Co.*, 19 Mo. App. 349.

"Trustees" of benefit associations cannot vote themselves back pay. *State v. Benefit Association*, 42 O. St. 579.

⁶ *Holland v. Lewiston Falls B'k*, 52 Me. 564; *Kilpatrick v. Penrose Ferry Bridge Co.*, 49 Pa. St. 118; *Sawyer v. Pawner's Bank*, 6 Allen, 207; *Merrick v. Peru Coal Co.*, 61 Ill. 472; *Gridley v. Lafayette, etc. R'y Co.*, 71 Ill. 200; *Emporium Real Estate Co. v. Emrie*, 54 Ill. 345; *Santa Clara M'g Ass'n v. Meredith*, 49 Md. 389; *Citizens' Nat. B'k v. Elliott*, 55 Iowa, 104. Same principles held to apply to a treasurer in *Kilpatrick v. Penrose Ferry Bridge Co.*, *supra*; *Holder v. Lafayette, etc. R'y Co.*, 71 Ill. 106.

ing to a number of decisions, recover the fair worth of such services in the absence of any resolution providing for his compensation.¹ Agents and servants of the corporation, other than the directors, president, and perhaps treasurer, may recover the value of their regular or extraordinary services on a *quantum meruit*.²

§ 648. It has recently been held in New York that when a life insurance company has contracted with a person to act as its general agent for a stipulated number of years at a specified yearly salary, and the company is dissolved by the action of the state, and its affairs placed in the hands of a receiver, before the expiration of the term for which the agent was hired, he cannot recover from the funds in the hands of the receiver his stipulated salary for the unexpired term of service, as damages for not continuing the employment. The contract was ended with the corporate dissolution by the action of the state, a contingency which the parties on contracting were held to have contemplated; and was not broken by the company itself.³

¹ *Santa Clara M'g Ass'n v. Meredith*, 49 Md. 389; *Cheaney v. Lafayette, etc. R'y Co.*, 68 Ill. 570; *S. C.*, 87 Ill. 446; *Rockford, etc. R. R. Co. v. Sage*, 65 Ill. 328; *Jackson v. New York Central R. R. Co.*, 2 T. & C. (N. Y.) 653; *Gardner v. Butler*, 30 N. J. Eq. 702, 721; *Shackelford v. New Orleans, etc. R. R. Co.*, 37 Miss. 202; *Citizens' Nat. B'k v. Elliott*, 55 Iowa, 104; *Rogers v. Hastings, etc. R'y Co.*, 22 Minn. 25; *Missouri River R. R. Co. v. Richards*, 8 Kan. 101. See *Henry v. Rutland, etc. R. R. Co.*, 27 Vt. 435; *Hodges v. Same*, 29 Vt. 220. *Contra*, *Levisse v. Shreveport City R. R. Co.*, 27 La. Ann. 641; *Pew v. Gloucester Nat. B'k*, 130 Mass. 391.

² *E. g.*, a superintendent can. *Bee v. San Francisco, etc. R. R. Co.*, 46 Cal. 248; or a secretary, who is not a trustee, or stockholder. *Smith v. Long Island R. R. Co.*, 102 N. Y.

190. Compare *Eagle, etc. M'fg Co. v. Brown*, 58 Ga. 240.

A corporation may agree to pay an agent for his labor in obtaining stock subscriptions. *Cincinnati, I. and C. R. R. Co. v. Clarkson*, 7 Ind. 595. Or for such services a person may recover on an implied promise. *Hall v. Vermont and Mass. R. R. Co.*, 28 Vt. 401; *Low v. Connecticut, etc. R. R. Co.*, 45 N. H. 370. A treasurer, secretary, or cashier is *prima facie* entitled to compensation; but if he agrees to perform the services gratis, this controls. *First Nat. B'k v. Drake*, 29 Kans. 311. In the absence of express agreement, a treasurer is not entitled to compensation for indorsing notes of his corporation, so that they can be discounted. *Parker v. Nickerson*, 137 Mass. 487.

³ *People v. Globe Mutual Ins. Co.*, 91 N. Y. 174.

§ 649. Whether, by whom, and on what grounds a corporate officer may be removed from office is not settled by the authorities.¹ That his original election was invalid is undoubtedly a good ground.² But this ground has nothing to do with the good or bad conduct of the officer himself; and invalidates his original title. Undoubtedly, agents who hold office merely at the pleasure of superior officers may be removed by the latter; and without cause.³ And the by-laws may, and, to avoid controversy, certainly should provide for removals from office.⁴

§ 650. Whatever implied power to remove officers for cause there may be in a corporation; would seem to exist in that body which appointed or elected the officer in question. Thus very likely any officer appointed by the board of directors or trustees could for cause be removed by them from the office to which they had appointed him. But a board of directors has no implied power, it would seem, to remove one of their own number, even for cause; or exclude him from taking part in their proceedings.⁵ It would seem, however, that for good grounds the majority of shareholders in a duly summoned meeting of the corporation should be competent to remove a director. But in the ordinary case of directors elected annually to serve for a year, there is no power in the corporation to remove them arbitrarily before the expiration of their term of office.⁶

¹ In *Angell and Ames on Corp.*, §§ 425 *et seq.*, is given a summary of the causes that have been held grounds for removing officers of municipal corporations. How far these cases might be held applicable to stock corporations is a question.

² See §§ 577-581.

³ *Hunter v. Sun Mutual Ins. Co.*, 26 La. Ann. 13.

⁴ See *Hunter v. Sun Mutual Ins. Co.*, *supra*.

⁵ See § 808.

⁶ *Imperial Hydropathic Hotel Co. v. Hampson*, 23 Ch. Div. 1. Officers of a corporation who, on the expiration of their term of office, refuse to deliver to their successors its books, etc., may be compelled by mandamus. *Fasnacht v. German Literary Ass'n*, 99 Ind. 133. In *Ward v. Davidson*, 89 Mo. 445, directors were removed by the court for misconduct.

CHAPTER XI.

LEGAL RELATIONS BETWEEN THE CORPORATION AND ITS CREDITORS.

How they arise. General view, §§ 651, 652.	Liability of consolidated corporation, § 666.
Creditors have no voice in the corporate management, § 653.	Liability of corporation succeeding the debtor corporation, § 667.
Corporate assets a trust fund for creditors, §§ 654, 655.	Insolvent assignments, § 668.
Creditors may follow them, § 656.	Relative rights of creditors, § 669.
Transfer of assets to a new corporation, § 657.	Set-off, § 670.
Right of creditors to restrain their misapplication, §§ 658, 659.	Corporate property, when exempt from execution, § 671.
Rights of creditors regarding debts due the corporation. Unpaid stock subscriptions, §§ 660, 661.	Relations between a bank and depositors, § 672.
Creditors may enjoin wrongs threatening the corporation, § 662.	Lien of bank, § 673.
Creditors of an insolvent corporation not entitled to a receiver as a matter of course, § 663.	Bondholders, § 674.
Creditors cannot prevent dissolution, § 664.	Equitable mortgages, § 675.
Nor alteration of charter; nor consolidation. Survival of creditors' lien, § 665.	Railroad mortgages. Rolling stock, § 676.
	Invalid provisions in corporate securities, § 677.
	May not invalidate the securities, § 678.
	Corporate bonds negotiable, § 679.
	Coupons, § 680.
	Rights of bondholders, § 681.
	Remedies of bondholders, § 682.

§ 651. THE legal relations between a creditor and the corporation are occasioned either by a contract binding on the latter, or by a tort for which it is responsible. Before the claims of a creditor arise, and during the transaction itself on which his claims are based, the creditor is simply an outsider towards whom the corporation, or the corporate agent¹ with whom the creditor contracts, owes no duty not due to members of the public at large. And creditors will rarely have any standing in court to object to

How they
arise.
General
view.

¹ See §§ 752-755.

acts of the corporation done before their claims arose.¹ From the moment, however, that a person becomes a creditor, the corporation owes it to him to satisfy his claim from the corporate funds, and is under a duty towards him which he may enforce, not to waste the corporate funds, or divert them from the purposes for which they were set apart, so as to prevent the satisfaction of his claim. From that moment the corporation, having in charge funds in regard to which the creditor has rights, occupies, because it has such funds in charge,² a position of trust towards him. Moreover, when subsequently the corporation or its representatives deal with persons who are not yet creditors, they represent the creditors, whose rights have already arisen, to this extent, that the rights of the latter in the corporate funds are ordinarily bound by the acts of the corporation or its representatives.³

§ 652. The classes and legal characteristics of the acts which are binding on the corporation, as representative of the interests of all persons in the corporate enterprise, are discussed in Chapter VII., the chapter devoted to the treatment of the effect of acts done by or on behalf of a corporation in occasioning legal relations between it and persons with whom it deals. The present chapter is taken up with the discussion of the rights of creditors who by some transaction have acquired a valid claim on the corporate funds.

§ 653. The corporate constitution specifies, among other things, the objects of incorporation, to which the corporate funds are to be applied. To the application of the corporate funds to these objects in accordance with the constitution a creditor cannot object. As long as the affairs of the corporation are being carried on in good faith and in accordance with the constitution, a creditor cannot interfere in the corporate management.⁴

¹ When a corporation, solvent at the time, with no actual intent to defraud its creditors, conveys its lands for an inadequate consideration, its subsequent creditors cannot question the transaction. *Graham v. Railroad Co.*, 102 U. S. 148.

² See §§ 41-47.

³ See § 525; also *Railway Co. v. Alling*, 99 U. S. 463.

⁴ This is the general rule. But nowadays bondholders are sometimes expressly accorded the right to vote. The effect of such a stipulation remains open for adjudication.

§ 654. It is not to be inferred, however, that the only rights of a general creditor are to sue for his debt, and, on recovery of a judgment, levy a fruitless execution on the departed funds of an insolvent corporation. He has many important rights, all more or less based on or related to the fundamental doctrine that the purposes for which corporate funds are set apart include the payment of the corporate indebtedness; and that for this, among other purposes, these funds are held in trust.

Corporate
assets a
"trust-
fund" for
creditors.

§ 655. There seems to be no longer the slightest question as to the firm establishment of this doctrine. It was first formulated by Justice Story in *Wood v. Dummer*, where the learned justice said:¹ "It appears to me very clear, upon general principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of debts contracted by the bank. The public as well as the legislature have always supposed this to be a fund appropriated for such purpose. The individual stockholders are not liable for the debts of the bank in their private capacities. The charter relieves them from personal responsibility, and substitutes the capital stock in its stead. Credit is usually given to this fund by the public as the only means of repayment. During the existence of the corporation it is the sole property of the corporation, and can be applied only according to the charter; that is, as a fund for the payment of its debts, upon the security of which it may discount and circulate notes. Why otherwise is any capital required by our charters? If the stock may the next day after it is paid in be withdrawn by the stockholders without payment of the debts of the corporation, why is its amount so strenuously provided for, and its payment by the stockholders so diligently required? To me this point appears so plain upon principles of law as well as common sense, that I cannot be brought into any doubt that the charters of our banks make the capital stock a trust fund for the payment of all the debts of the corporation."

Again, in *Sanger v. Upton*, giving the opinion of the Federal Supreme Court, Justice Swayne said:² "The capital stock of

¹ 3 Mason, 308, 311.

² 91 U. S. 56, 60.

an incorporated company is a fund set apart for the payment of its debts. It is a substitute for the personal liability which subsists in private co-partnerships. When debts are incurred, a contract arises with the creditors that it shall not be withdrawn or applied, otherwise than upon their demands, until such demands are satisfied. The creditors have a lien upon it in equity. If diverted they can follow it as far as it can be traced, and subject it to the payment of their claims, except as against holders who have taken it *bona fide* for a valuable consideration, and without notice. It is publicly pledged to those who deal with the corporation for their security. Unpaid stock is as much a part of this pledge, and as much a part of the assets of the company, as the cash which has been paid in upon it. Creditors have the same right to look to it as to anything else, and the same right to insist upon its payment as upon the payment of any other debt due the company.”¹

§ 656. If the corporate funds are trust funds for the discharge of the corporate indebtedness, it follows on well-grounded principles of equity jurisprudence, that the beneficiaries of the trust, shareholders or creditors, can claim such funds in the hands of any one who has not in good faith given value for them without notice of a violation of the trust.² And, moreover, every one receiving corporate

Creditors
may follow
them.

¹ Accord, *Bartlett v. Drew*, 57 N. Y. 587; *Hastings v. Drew*, 76 N. Y. 9; *County of Morgan v. Allen*, 103 U. S. 498; *Lee v. Imbrie*, 13 Oreg. 510; *Lane's Appeal*, 105 Pa. St. 49, and cases in succeeding notes.

The doctrine is sometimes embodied in a statute. “No association, or any member thereof, shall during the time it shall continue its banking operations withdraw or permit to be withdrawn, either in the form of dividends or otherwise, any portion of its capital. If losses have at any time been sustained by any such association, equal to or exceeding its undivided profits then on hand, no dividend shall be made; and no dividend shall ever be

made by any association, while it continues its banking operations, to an amount greater than its net profits then on hand, deducting therefrom its losses and bad debts.” U. S. Rev. Stat., § 5204.

² The property of a corporation “is so far as regarded in the nature of trust property that it can be recovered by the company from any person who has obtained it from the directors with notice that they are acting beyond their powers.” 2 Lindley on Part., 593. See *Bryson v. Warwick, etc. Canal Co.*, 4 De G. M. & G. 711; *Ernest v. Croysdill*, 2 De G. F. & J. 175; *Hardy v. Metropolitan Land, etc. Co.*, L. R. 7 Ch. 427.

funds knowing them to be such, is affected with notice of the purposes for which they are held in trust. That corporate funds may be tracked by creditors into the hands of any person to whom they have been transferred without consideration is a proposition supported unanimously by the authorities.¹

§ 657. Accordingly, a corporation cannot place its assets beyond the reach of its creditors, merely by going through a process of re-incorporation, taking a new name, transferring without consideration the assets of the old corporation to the new one, and issuing shares in the capital stock of the new corporation to holders of shares in the capital stock of the old.² And if the shareholders of one corporation organize another, and transfer to it all the property of the former without paying the former's debts, the obligations of the old company may be enforced against the new one to the extent of the assets transferred to it.³ It is held, however, that before a creditor has a standing in court to inquire into a transfer of assets made by his debtor corporation he must have obtained judgment against it.⁴

Transfer of assets to a new corporation.

¹ *Wood v. Dummer*, 3 Mason, 308; *Wright v. Petrie*, 1 Sm. & M. Ch. (Miss.) 282; *Marr v. Bank of West Tennessee*, 4 Coldw. (Tenn.) 471; *Tinkham v. Borst*, 31 Barb. 407; *Goodwin v. McGehee*, 15 Ala. 232; *Jones v. Arkansas Mechanical Co.*, 38 Ark. 17; *Union Nat. Bank v. Douglass*, 1 McCrary, 86. See *Curran v. State*, 15 How. 304, 307; *Railroad Co. v. Howard*, 7 Wall. 393, 409. *Montgomery, etc. R. R. Co. v. Branch*, 59 Ala. 139.

² *San Francisco, etc. R. R. Co. v. Bee*, 48 Cal. 398.

³ *Hibernia Ins. Co. v. St. Louis, etc. Transportation Co.*, 13 Fed. Rep. 516; *Booth v. Bunce*, 33 N. Y. 139; *Barclay v. Quicksilver M'fg Co.*, 9 Abb. Pr. N. S. (N. Y.) 283; *Same v. Same*, 6 Lans. (N. Y.) 25; *Kelly v. Mariposa Land, etc. Co.*, 4 Hun (N. Y.), 632; *Brum v. Merchant's*

Mut. Ins. Co., 16 Fed. Rep. 140. Unsecured creditors of a corporation have a lien on its property transferred to a succeeding corporation superior to the lien of bondholders under a mortgage executed by the succeeding corporation; the succeeding corporation having given only its own stock in payment for such property. *Montgomery, etc. R. R. Co. v. Branch*, 59 Ala. 139.

But a judgment against the prior corporation, recovered on a claim for personal injuries occurring after the transferral of its property to a succeeding corporation, cannot be enforced against that property in possession of the succeeding corporation. *Gray v. National Steamship Co.*, 115 U. S. 116.

⁴ *Tawas, etc. R. R. Co. v. Circuit Judge*, 44 Mich. 479. See also *Smith v. Railroad Co.*, 99 U. S. 398.

§ 658. On the principle that the funds of a corporation are held in trust for its creditors, is also based the only right of the latter to interfere with the management of the corporate affairs. If the corporate funds are being dissipated or applied to purposes beyond the scope of the corporate objects in such a way as to imperil the solvency of the corporation and the lien of the creditors on its funds, a creditor can restrain the misapplication.¹ This would seem to follow *à fortiori* from the rule that a creditor can follow corporate funds into the hands of any one receiving them with notice of their misapplication; and the remedy of the creditor is to apply for an injunction and the appointment of a receiver.²

§ 659. In *Kearns v. Leaf*, and *Aldebert v. Kearns*,³ two English cases decided together, a policy-holder in a joint-stock insurance company, the shareholders of which were not subject to personal liability, and whose funds, by provisions in the company's deed and in the plaintiff's policy, were liable for the sum insured, was granted an injunction restraining the company from transferring its assets to another company, without first providing for the payment of the plaintiff's policy. Vice-Chancellor Page-Wood said: "I apprehend that under these stipulations the policy-holders have no right to meddle with anything, wise or unwise, which the company may do in accordance with the deed. For example, if the company invest in a hazardous or even ruinous security, the policy-holders are not entitled to interfere. It would be extremely mischievous to allow such interference. Still, the conduct of the company might reach a point of absolute waste of the assets in contra-

¹ The English cases do not recognize as fully as the American the doctrine that corporate funds are held in trust for creditors. In England there has never been the same necessity for the doctrine, as English companies are more apt to be of unlimited personal liability. Accordingly, the last proposition in the text may not be law in England. See *Mills v. Northern R'y Co.*, L. R. 5 Ch. 621.

² *Conro v. Gray*, 4 How. Pr. (N. Y.) 166. There the court said that it

could appoint a receiver or require security for the due preservation and appropriation of the property. See *Fisk v. Union Pacific R. R. Co.*, 10 Blatchf. 518; *Innes v. Lansing*, 7 Paige (N. Y.), 583; *Whitcomb v. Fowle*, 7 Abb. N. C. (N. Y.) 295; *Irons v. Manufacturers' Nat. B'k*, 6 Biss. 301; *Lotrop v. Stedman*, 13 Blatchf. 134. Compare *Bank of St. Mary's v. St. John*, 25 Ala. 566.

³ 1 Hem. & Mil. 681.

vention of the provisions of the deed, at which the right of the policy-holders to intervene might be considered to arise. . . . The principle on which the plaintiff's case is founded here, is, that the fund which was held out to him as his security, and to which he has himself contributed, shall not be misapplied contrary to the provisions of the deed. He says that he comes here to prevent a waste of the assets. His position is somewhat analogous to that of a person having a contingent debt against a testator's estate, who may come into this court to prevent the estate being paid away to legatees, or wasted, or thrown away by the executors. The argument of the company, as I understand it, goes this length, that the policy-holder is simply a contingent future creditor *minus* the personal remedy. If that were the whole of the contract, it would be very different from what persons who insured in the company must have supposed. They could not have imagined that it was to be in the power of the directors or the company to destroy all their interests under their policies, leaving them without redress until their policies should have matured by death. . . . In my opinion the plaintiff did acquire under that contract such a species of interest in the fund as would entitle him to interfere to save the property from being wasted contrary to the provisions of the deed."¹

§ 660. Not only has a creditor the right to restrain an improper dissipation of funds of the corporation actually in its possession, but he has the further right, if these do not suffice for the payment of the debt due him, to compel the debtors of the corporation to pay their debts.² This right of the creditors also is usually rendered effective through the appoint-

Rights of creditors regarding debts due the corporation. Unpaid stock subscriptions.

¹ 1 Hem. & Mil. 707-708. See also *Evans v. Coventry*, 5 De G. M. & G. 911; *In re State Fire Ins. Co.*, 1 Hem. & Mil. 457.

An insurance company has no right to turn its policy-holders over to another company against their consent, and policy-holders are under no obligation to protest, in order to preserve their rights. An insurance company con-

tracts to keep on hand the funds required by law for the security of its patrons; and also to continue its business so as to keep in a condition to perform its engagements. *People v. Empire Mut. Life Ins. Co.*, 92 N. Y. 105.

² Before an alleged creditor of a railroad company can file a creditor's bill to obtain from one of its debtors

ment of a receiver, who will be competent to collect all debts owing the corporation, for the benefit of persons interested, shareholders or creditors. Especially is it competent for the receiver or assignee in insolvency to collect—and incumbent on him to do so—all unpaid stock subscriptions.¹

§ 661. As stated in *Sanger v. Upton*,² unpaid stock subscriptions, just as much as subscriptions actually paid in, constitute part of the capital of the corporation, of the trust fund devoted to the discharge of its indebtedness. Ordinarily, as long as the corporation is a going concern under the management of its regular officers, a call duly made by the board of directors is a condition precedent to the liability of a shareholder to pay any part of his unpaid subscription.³ If the directors fail to make a call when the unpaid subscriptions are needed to pay the debts of the corporation, a court of equity, on the suit of a creditor, will compel them to do so.⁴ Ordinarily, however, to apply for the appointment of a receiver is the course pursued.

§ 662. In cases of urgent necessity where the corporation fails to protect itself from threatened wrongs, it is competent for a creditor, when the wrong if accomplished would injure his vested rights, to enjoin the wrong.⁵ And, under such circumstances, it would seem that the principle that a shareholder cannot maintain a bill in equity against a wrongdoer to prevent an injury to the corporation unless he shows that the corporation

Creditors
may enjoin
wrongs
threatening
the corpo-
ration.

the satisfaction of his claim, he must establish his debt by a judgment in an action at law. *Smith v. Railroad Co.*, 99 U. S. 398. A judgment creditor can garnishee a shareholder (on a judgment against the corporation) for unpaid calls due the corporation. *Meints v. East St. Louis, etc. Mill Co.*, 89 Ill. 48.

¹ See § 542.

² § 655.

³ See §§ 703, 517, 543.

⁴ *Germantown Passenger Ry. Co. v. Fittler*, 60 Pa. St. 124; *Ward v. Griswoldville M'fg Co.*, 16 Conn. 593,

601; *Glenn v. Williams*, 60 Md. 93; *Scoville v. Thayer*, 105 U. S. 143, 155; *Salmon v. Hamborough Co.*, 1 (Eng.) Chan. Cas. 204; see *Ogilvie v. Knox Ins. Co.*, 2 Black, 539; S. C., 22 How. 380; *Allen v. Montgomery R. R. Co.*, 11 Ala. 437; *Adler v. Milwaukee Patent Brick M'fg Co.*, 13 Wis. 57; *Dalton, etc. R. R. Co. v. McDaniel*, 56 Ga. 191; 2 Lindley on Part. 628; compare *Reg. v. Victoria Park Co.*, 1 Q. B. 288.

⁵ *Newby v. Oregon Central R. R. Co.*, Deady, 609.

has refused to take measures to protect itself, does not apply to a bill filed in good faith by a creditor.¹

§ 663. The insolvency of a corporation so long as it continues to carry on its business in an honest manner, does not under all circumstances give the creditors an absolute right to the appointment of a receiver of the corporate assets.² Any such absolute right might often prove very oppressive, and, like other peculiarly equitable remedies, the appointment of a receiver is usually a matter within the discretion of the court.³ Thus, according to a Massachusetts decision, the allegations that a corporation is insolvent, that all its property is mortgaged to trustees for the benefit of one class of creditors; that it owes large amounts to other creditors, one of which has attached its property; that it is about to execute a lease for nine hundred and ninety-nine years to said attaching creditor, will not sustain a bill in equity brought by creditors of the corporation to enjoin it from doing business and for the appointment of receivers.⁴ But a judgment creditor is entitled to a receiver on showing that there is danger that a corporation, admittedly insolvent, will misappropriate its assets to his injury.⁵

Creditors of an insolvent corporation not entitled to a receiver as a matter of course.

It follows, moreover, since it is only to protect their claims that creditors are ever entitled to interfere in the corporate affairs, that they can object to no action, authorized or unau-

¹ Lothrop v. Stedman, 42 Conn. 583; S. C., 13 Blatchf. 141.

² See Catlin v. Eagle Bank, 6 Conn. 233; Pondville Co. v. Clarke, 25 Conn. 97; Bishop v. Brainerd, 28 Conn. 289, 301; Hoyt v. Shelden, 3 Bosw. (N. Y.) 267; Curtis v. Leavitt, 15 N. Y. 10, 198.

³ But not always; see Railroad Co. v. Soutter, 2 Wall. 510. A receiver cannot be appointed *ex parte* in a proceeding (a bill in equity) brought by a creditor to wind up an insolvent corporation, pending the decision on a demurrer putting in issue the creditor's right to file the bill. Cook v. Detroit, etc. R. R. Co., 45 Mich. 453.

⁴ Pond v. Framingham, etc. R. R. Co., 130 Mass. 194. Compare Merchants', etc. Bank v. Trustees, 63 Ga. 549. Still at the suit of a judgment creditor a court of equity has power to take possession of the property (a bridge) of a corporation, and appoint a receiver to collect the tolls and pay them into court, for the purpose of paying the judgment. Covington Drawbridge Co. v. Shepherd, 21 How. 112. A creditor may enforce his claims, though he be also a shareholder. Brinham v. Wellersburg Coal Co., 47 Pa. St. 43.

⁵ Turnbull v. Prentiss Lumber Co., 55 Mich. 387.

thorized, on the part of the corporate management, which does not injure their interests. Thus, a court of equity will not, on the petition of a general creditor, restrain a corporation from converting its assets into money by a sale to a shareholder, when no shareholder objects, and the sale is honestly made for an adequate price, with intent to apply the proceeds *pro rata* to the payment of the corporate indebtedness.¹

§ 664. Accordingly, a creditor cannot prevent the dissolution of a corporation.² For the obligation of contracts entered into by the corporation survives the dissolution; and creditors may still enforce their claims against any corporate property which has not passed into the hands of *bona fide* purchasers.³ "A corporation by the very terms and nature of its political existence, is subject to dissolution, by a surrender of its corporate franchises and by a forfeiture of them for wilful misuser and nonuser. Every creditor must be presumed to understand the nature and incidents of such a body politic, and to contract with reference to them. And it would be a doctrine new in the law that the existence of a private contract of the corporation should force upon it a perpetuity of existence contrary to public policy and the nature and objects of its charter."⁴

¹ Barr v. Bartram M'fg Co., 41 Conn. 506. Compare Swepson v. Bank, 9 Lea (Tenn.) 713.

² Mumma v. Potomac Co., 8 Pet. 281; Smith v. Chesapeake, etc. Canal Co., 14 Pet. 45; Curran v. State, 15 How. 310; Mobile R. R. Co. v. State, 29 Ala. 586. Neither will a court forfeit the corporate franchises at the suit of creditors, although acts constituting a ground of forfeiture have been done. Gaylord v. Ft. Wayne, etc. R. R. Co., 6 Biss. 286. See Cole v. Knickerbocker Life Ins. Co., 23 Hun, 255.

³ Mumma v. Potomac Co., 8 Pet. 281, 286; Howe v. Robinson, 20 Fla. 352. But it has been held that the plaintiff in a suit in equity may enjoin

a corporation, defendant in the suit, which might be held liable to respond pecuniarily to the plaintiff, and which had made one attempt to procure its dissolution, from dissolving, or having a receiver appointed, or distributing its assets among its shareholders or from making any disposition of its property. Fisk v. Union Pacific R. R. Co., 10 Blatchf. 518.

⁴ Mumma v. Potomac Co., 8 Pet. 281, 287, opinion of the court per Story, J.

A corporation, composed of two other corporations, had been dissolved after the recovery of a judgment against it. By the dissolution, the two original companies resumed their corporate existence. It was held that such dis-

§ 665. Neither can creditors prevent the alteration or repeal of the charter of a corporation,¹ as under such circumstances the capital of the corporation remains charged with their equitable liens.² And finally, creditors cannot prevent a consolidation of their debtor corporation with another. But a corporation cannot compel its creditors to give up their lien on its funds, and accept in lieu thereof the personal liability of the consolidated corporation.³ The equitable lien of the creditors of a consolidating corporation survives, and they may obtain satisfaction from its property after the same has passed to the consolidated corporation.⁴ And where a suit is pending against a corporation at the time of its consolidation, the plaintiff may still treat it as having a separate existence for the purpose of maintaining his action against it.⁵

Nor alteration of charter; nor consolidation. Survival of creditors' lien.

solution did not affect the rights of the judgment creditor, nor the validity of his judgment; and that upon notice to the two companies he was entitled to an execution against them. *Ketcham v. Madison, etc. R. R. Co.*, 20 Ind. 260.

¹ *Read v. Frankfort Bank*, 23 Me. 318. See *Pennsylvania College Cases*, 13 Wall. 190, 218-220; *Lothrop v. Stedman*, 13 Blatchf. 134, 143. As to the repeal of provisions inserted in a charter specially for the benefit of creditors, see *Hawthorne v. Calef*, 2 Wall. 10, and §§ 500, 501.

² See cases in preceding note.

³ *In re Manchester, etc. Life Ass. Ass'n*, L. R. 9 Eq. 643; *In re Family Endowment Society*, L. R. 5 Ch. 118; *Griffith's Case*, L. R. 6 Ch. 374; *In re India, etc. Life Ass. Co.*, L. R. 7 Ch. 651. Compare *Terhune v. Potts*, 47 N. J. L. 218. See §§ 425-427.

Still it has been held that after a railroad company has consolidated with another as authorized by their charters, and confirmed by legislation

conferring all rights, powers, and privileges belonging to either on the new corporation, liabilities of either of the old companies can be enforced *only* against the new corporation. *Indianola R. R. Co. v. Fryer*, 56 Tex. 609. Compare *Houston, etc. R. R. Co. v. Shirley*, 54 Tex. 125; *People v. Empire Mut. Life Ins. Co.*, 92 N. Y. 105; § 659.

⁴ *Powell v. North Missouri R. R. Co.*, 42 Mo. 63. Thus, of course, a mortgage lien may be enforced against property covered by it, after the consolidation. *Eaton, etc. R. R. Co. v. Hunt*, 20 Ind. 457. See *Racine, etc. R. R. Co. v. Farmers' Loan and Trust Co.*, 49 Ill. 331. Likewise, a maritime lien on a vessel remains after the consolidation of the corporation owning the vessel. *The Key City*, 14 Wall. 653.

⁵ *Shackleford v. Mississippi Central R. R. Co.*, 52 Miss. 159; *Baltimore and Susquehanna R. R. Co. v. Muselman*, 2 Grant's Cas. (Pa.) 348; *East Tennessee, etc. R. R. Co. v.*

§ 666. The consolidated company is in most cases held to assume a personal liability for the obligations of the prior corporations whose property it has acquired, and of which it may be regarded as the result.¹ Accordingly, an action at law may be brought against the consolidated company on the obligation of one of the prior companies.² When, however, at the time of the consolidation, a suit against one of the former companies is pending, the consolidated company must be substituted in the action or in some way properly brought into court, before a judgment against it can be taken.³

§ 667. When there has been no consolidation of a debtor corporation with another, the creditors of the former will have no right to enforce their claims personally against the latter merely because it has acquired the assets of the former,⁴ unless the succeeding corporation is merely a continuance of the old one or a revival of it under a new charter.⁵ Moreover, that the name,

Liability of
consoli-
dated cor-
poration.

Liability of
corpora-
tion suc-
ceeding the
debtor cor-
poration.

Evans, 6 Heisk. (Tenn.) 607. See *Bruffett v. Gt. Western R. R. Co.*, 25 Ill. 353, 357.

It would seem, nevertheless, that if—as is usually the case—the consolidation effects a dissolution of the former corporations (see § 421), some change or substitution of parties would be necessary: for on dissolution suits against a corporation *eo nomine* abate. See § 435, and see *Indianola R. R. Co. v. Fryer*, *supra*.

¹ *Indianapolis, etc. R. R. Co. v. Jones*, 29 Ind. 465; *Columbus, etc. R'y Co. v. Powell*, 40 Ind. 37; *Thompson v. Abbott*, 61 Mo. 176; *Miller v. Lancaster*, 5 Coldw. (Tenn.) 514, 520. See *Houston, etc. R. R. Co. v. Shirley*, 54 Tex. 125; *Warren v. Mobile, etc. R. R. Co.*, 49 Ala. 582; § 425. But, see *Shaw v. Norfolk County R. R. Co.*, 16 Gay, 407; compare *Chase v. Vanderbilt*, 5 J. & S. (N. Y.) 334.

This is frequently provided for by

the statute authorizing the consolidation. See *Western Union R. R. Co. v. Smith*, 75 Ill. 496.

² *Columbus, etc. R'y Co. v. Skidmore*, 69 Ill. 566.

³ *Selma, etc. R. R. Co. v. Harbin*, 40 Ga. 706. Compare *Ketcham v. Madison, etc. R. R. Co.*, 20 Ind. 260.

⁴ *Bellows v. Hallowell, etc. B'k*, 2 Mason, 31; *Wyman v. Same*, 14 Mass. 58; *Bruffett v. Gt. Western R. R. Co.*, 25 Ill. 353. See § 415. But creditors may under some circumstances follow the property of their debtor corporation. See § 657.

⁵ *Mayor, etc. of Colchester v. Seaber*, 3 Burr. 1866; see *Broughton v. Pensacola*, 93 U. S. 266; and § 657.

Thus, when a state bank is reorganized into a national bank, under provisions of the National Banking Act, the national bank is liable for the obligations of the state bank. *Coffey v. National Bank*, 46 Mo. 140. Compare

and the major part of the shareholders and officers, of the old corporation were the same as those of the new, does not establish conclusively that the latter is a mere continuance of the former.¹ "To ascertain whether a charter creates a new corporation, or merely continues the existence of an old one, we must look to its terms, and give them a construction consistent with the legislative intent and the intent of the incorporators."²

§ 668. To allow an insolvent corporation to make an assignment of its property, giving preferences to a portion of its creditors over the others, is unjust, as well as utterly repugnant to the doctrine that corporate property is a trust fund, on the credit of which persons contract with the corporation. If such property constitutes such a fund, it is clearly held in trust for the benefit of one creditor just as much as another,³ and to prefer one creditor to another is evidently beyond the authority of the trustee. This view is far from being unsupported by direct authority.⁴ Thus a deed of general assignment to trustees to procure a loan, and then to pay certain debts of the corporation (a bank), and then others *pro rata*, the trustees receiving large salaries for their services, has been held void as against a non-consenting creditor.⁵ Still there is no doubt that an insolvent corporation may make a

Insolvent
assign-
ments.

State v. National Bank, 33 Md. 75. A corporation is not liable for the debts of a firm, though the members of the firm constitute the shareholders, and the firm assets have been transferred to the corporation. McLellan v. Detroit File Works, 56 Mich. 579. See Georgia Co. v. Castleberry, 43 Ga. 187.

¹ See cases in last note but one.

² Story, J., in Bellows v. Hallowell B'k, 2 Mason, 31, 44. See also Miller v. English, 21 N. J. Law, 317; People v. Marshall, 1 Gilman (Ill.), 672; Goulding v. Clark, 34 N. H. 148.

³ Dabney v. Bank of South Carolina, 3 S. C. 124.

⁴ Robins v. Embry, 1 Sm. & M.

Ch. (Miss.) 207, 258 *et seq.*; Bodley v. Goodrich, 7 How. 276; Swepson v. Bank, 9 Lea (Tenn.), 713. See Hightower v. Mustian, 8 Ga. 506; Marr v. Bank of West Tennessee, 4 Coldw. (Tenn.) 471; Richards v. New Hampshire Ins. Co., 43 N. H. 263. Certain corporations, as, *e. g.*, national banks, are expressly forbidden by their constitutions to make preferences after or in contemplation of insolvency. U. S. Rev. Stat., § 5242.

When an insolvent national bank is making illegal preferential payments, a court will appoint a receiver at the suit of a depositor. Irons v. Manufacturers' Nat. B'k, 6 Biss. 301.

⁵ Bodley v. Goodrich, 7 How. 276.

valid assignment for the benefit of its creditors;¹ and a number of cases have held that an insolvent corporation may make such an assignment with preferences.²

§ 669. A court of equity, however, will regard the relative rights of different creditors, and will restrain one creditor from absorbing, after the corporation has become insolvent, its available assets to the unjust exclusion of other creditors.³ Thus, the property of a national

Relative
rights of
creditors.

¹ *Ardesco Oil Co. v. North Am. Oil, etc. Co.*, 66 Pa. St. 375; *State v. Bank of Maryland*, 6 Gill & J. (Md.) 205; *Union B'k v. Ellicott*, ib. 363; *Shockley v. Fisher*, 75 Mo. 498; *Lionberger v. Broadway S'v'gs B'k*, 10 Mo. App. 499; *Lamb v. Cecil*, 25 W. Va. 288. The board of directors of an insolvent corporation may make an assignment (without preferences) of its property for the benefit of creditors. *Descombes v. Wood*, 91 Mo. 196; *Hutchinson v. Green*, 91 Mo. 367.

² *Ringo v. Biscoe*, 13 Ark. 563; *Savings Bank v. Bates*, 8 Conn. 505; *Whitwell v. Warner*, 20 Vt. 425; *Arthur v. Commercial, etc. Bank*, 17 Miss. 394; *Wilkinson v. Bauerle*, 41 N. J. Eq. 635; *Vail v. Jameson*, 41 N. J. Eq. 648. See *Catlin v. Eagle Bank*, 6 Conn. 233. Compare *Hopkins v. Gallatin Turnpike Co.*, 4 Humph. (Tenn.) 403; *Pope v. Brandon*, 2 Stew. (Ala.) 401; *Coats v. Donnell*, 94 N. Y. 160.

In the absence of lien created by contract, or rights created by legal proceedings, the officers of a corporation may exercise a reasonable and proper discretion as to the order in which debts of the corporation shall be paid. *Newport, etc. Bridge Co. v. Douglass*, 12 Bush (Ky.), 73. But after a judgment creditor's bill has been filed the officers cannot go on converting corporate assets into money

and paying creditors, giving preferences. *Turnbull v. Prentiss Lumber Co.*, 55 Mich. 387. Compare *Prentiss v. Nichols*, 100 U. S. 227.

Proof that at the time of the delivery of a mortgage by a corporation, the corporation was insolvent, as a matter of fact, is not conclusive evidence that the transfer (mortgage) was made "in contemplation of the insolvency of such company" within the meaning of a statute (1 N. Y. R. S. 603, § 4) declaring such transfers unlawful; to come within the prohibition of the statute, the act must have been induced by the existing or contemplated insolvency of the company. (The creditor in this case was not an officer.) *Paulding v. Chrome Steel Co.*, 94 N. Y. 334. See also *Dutcher v. Importers and Traders' Bank*, 59 N. Y. 5. Compare *Robinson v. Bank of Attica*, 21 N. Y. 406; and *Haxtun v. Bishop*, 3 Wend. 13. An offer to allow judgment to be entered against it by a corporation is a transfer of its property within the meaning of this statute. *Kingsley v. First National Bank*, 31 Hun (N. Y.), 329.

³ See *Pfohl v. Simpson*, 74 N. Y. 137; *Whittlesey v. Delaney*, 73 N. Y. 571; *Turnbull v. Prentiss Lumber Co.*, *supra*. § 813.

In a foreclosure suit a court of equity will prevent, if possible, the sale of the central portion of a railroad which

bank attached at the suit of a creditor, after the bank has become insolvent, cannot be subjected to sale for the payment of a demand, as against the claim for the property by a receiver of the corporation subsequently appointed.¹ And a suit against a national bank to collect a debt is abated by a decree of a Federal District Court dissolving the corporation and forfeiting its franchises, rendered upon an information against the bank filed by the comptroller of the currency.²

§ 670. A person who is a debtor to the corporation on one account and its creditor on another, may ordinarily set off against what he owes the corporation the debt which the corporation owes him. Thus, a banker who was a director in an insurance company, can set off against its demand for money deposited with him, bearing interest and payable on call, the amount due on its policies issued to and held by him. And, the company having been adjudged bankrupt, his right to such a set-off is equally available against its assignee.³ But a shareholder cannot set off a debt owing him from the corporation, if the latter is insolvent, against his liability for unpaid subscriptions.⁴ And in all cases, in order to entitle a debtor of the corporation to set off a claim against it, the claim must have been acquired before the assets of the corporation have come under the control of a court of equity.⁵

would leave the two ends valueless. Chicago, Danville, etc. R'y Co. v. Loewenthal, 93 Ill. 533.

¹ National Bank v. Colby, 21 Wall. 609.

² National Bank v. Colby, *supra*. Compare Bank of Bethel v. Pahquoque Bank, 14 Wall. 383. Under the National Banking Act, a creditor of a national bank who establishes his debt by suit and judgment after refusal of the comptroller of the currency to allow it, is entitled to share in dividends on his debt (and on the interest then due) so established as of the day of the failure of the bank; and not upon the basis of the judgment, if the judgment includes interest subsequent

to that date. White v. Knox, 111 U. S. 784.

³ Scammon v. Kimball, 92 U. S. 362.

⁴ See § 729.

⁵ Smith v. Mosby, 9 Heisk. (Tenn.) 501; Lanier v. Gayoso Savings Inst., ib. 506. See §§ 810, 811. When a corporation places its funds in the hands of its general manager as trustee for safe-keeping and to use in the affairs of the corporation, such trustee cannot, in the event of the corporation's insolvency, set off a debt owing him from the corporation against the claim of its assignee for creditors for such moneys. First National Bank v. Barnum Wire Works, 58 Mich. 124.

§ 671. When a corporation is created in order to subserve some public purpose, its creditors may not be permitted, for reasons of public policy, to enforce their rights in a manner that would render the corporation incapable of fulfilling its public duty. Thus, a corporate franchise to take tolls on a canal cannot be seized and sold under an execution, unless express authority to that effect exists in some statute of the state granting the charter.¹ Neither can lands or works essential to the enjoyment of a franchise be separated from it, and sold under such process.² But lands belonging to a railroad company, which are not used for corporate purposes, nor necessary to the full enjoyment and exercise of the corporate franchises, may be sold on execution against the corporation.³

The relations between a corporation and certain special classes of its creditors may now be more particularly referred to. •

§ 672. When an ordinary deposit is received by a bank and placed to the credit of the depositor, the relation neither of principal and agent, nor of bailor and bailee is created, but that of debtor and creditor.⁴ Consequently the bank has the right to apply the money to the payment of any legal demand it may have at the time against the depositor; and, on the other hand, will be liable to the depositor for any loss of the money, although occurring without any fault on the part of the bank or its servants.⁵ When, however, a person deposits drafts in a bank

¹ *Gue v. Tide Water Canal Co.*, 24 Pa. St. 465. See also *State v. Rives*, 5 Ired. L. (N. C.) 297.

² *Gue v. Tide Water Canal Co.*, *supra*. *East Alabama R'y Co. v. Doe*, 114 U. S. 340; *Youngman v. Elmira*, etc. R. R. Co., 65 Pa. St. 278. See also in regard to personal property belonging to a railroad, *Philips v. Winslow*, 18 B. Mon. (Ky.) 431, where the same principle was applied. Compare § 334.

³ *Plymouth R. R. Co. v. Colwell*, 39 Pa. St. 337. See *Shamokin Val-*

ley R. R. Co. v. Livermore, 47 Pa. St. 465.

⁴ *Phoenix Bank v. Risley*, 111 U. S. 125; *Davis v. Smith*, 29 Minn. 201; *Hardy v. Chesapeake Bank*, 51 Md. 562; *Ward v. Johnson*, 5 Ill. App. 30, and cases in following notes. Depositors in savings banks stand in the same relation to the assets of the bank as shareholders in banks of discount. *Cogswell v. Rockingham Ten Cents Sv'gs B'k*, 59 N. H. 43; *Hall v. Paris*, ib. 71.

⁵ *Commercial Bank v. Hughes*, 17

known at the time to its managers to be insolvent, receiving the deposit is a fraud on the depositor, and he may reclaim the drafts or their proceeds, so long as they have not come into the hands of *bona fide* holders for value; thus rescinding what would otherwise have been the ordinary contract between a depositor and the bank, *i. e.*, that the bank should become the owner of the drafts and debtor for their equivalent.¹ There is no special trust relation between a bank and its depositors. But the bank is bound to know their signatures, and is liable to them for all moneys paid out on forged checks;² while the depositor is under no duty to the bank to examine his pass-book and vouchers for the purpose of detecting forgeries.³

In defending the interests of a depositor against a third person claiming the deposit, the bank will not be liable for neglect of its duty, if it takes reasonable legal measures in defence, and notifies the depositor of the suit. Under such circumstances it is not incumbent on the bank to make a strenuous defence or try to put the case off.⁴

Wend. 94; Marsh *v.* Oneida Central Bank, 34 Barb. 298; Ætna Nat. B'k *v.* Fourth Nat. B'k, 46 N. Y. 82; Boyden *v.* B'k of Cape Fear, 65 N. C. 13; *In re* B'k of Madison, 5 Biss. 515; Knecht *v.* United States Sv'gs Ins'n, 2 Mo. App. 563.

But a bank when sued by a depositor for his deposit cannot show that the deposit really belonged to third persons indebted to the bank, and set off its claim against them. First Nat. B'k *v.* Mason, 95 Pa. St. 113. Compare Swartwout *v.* Mechanics' Bank, 5 Denio, 555. Nor can a bank hold the balance of a customer's deposit, to apply it on his indebtedness to the bank not yet matured. Jordan *v.* Nat. Shoe and Leather B'k, 74 N. Y. 467.

¹ Cragie *v.* Hadley, 99 N. Y. 131.

² Leavitt *v.* Stanton, Lalor (N. Y.), 413; Morgan *v.* Bank of the State of New York, 11 N. Y. 404; Weissner *v.* Denison, 10 N. Y. 68; Commercial and Farmers' Nat. B'k *v.* First Nat.

B'k, 30 Md. 11. That the forger is the confidential clerk of the depositor is no defence, if the latter has himself done nothing to lead the bank to suppose the check authentic. Frank *v.* Chemical Nat. B'k, 84 N. Y. 209; Hardy *v.* Chesapeake Bank, 51 Md. 562. Compare U. S. Bank *v.* Bank of Georgia, 10 Wheat. 333. A bank is liable for money paid on altered checks. Crawford *v.* West Side B'k, 100 N. Y. 50.

³ Welsh *v.* German American Bank, 73 N. Y. 424; see Frank *v.* Chemical Nat. Bank, 84 N. Y. 209. As to the liability of savings banks for moneys paid out on forged checks or orders, see §§ 199, 245. The statute of limitations does not run against the claim of a depositor until demand and refusal. Branch *v.* Dawson, 33 Minn. 399. See Viets *v.* Union National Bank, 101 N. Y. 563.

⁴ Detroit Savings Bank *v.* Burrows, 34 Mich. 153.

§ 673. The facts of a carefully considered case decided not long ago in the Federal Supreme Court were as follows:¹ A bank account was opened in the name of a depositor known to the bank to be the general agent of an insurance company, and whose chief business, as the bank also knew, was to conduct the insurance agency. The words "gen'l ag't" were attached to the depositor's name in the account. The bank further knew that the account was opened to facilitate the business of the agency, and was used by the depositor as a means of accumulating premiums collected by him for the company, and making payments to it by checks. It was held that the bank was chargeable with notice of the equitable rights of the insurance company, although the depositor had deposited other moneys in the same account, and had drawn checks against it for his private use; and that the company might enforce in equity its beneficial ownership against the bank, which on its side set up a lien on the fund for a debt due from the depositor individually to it. Justice Matthews said, giving the opinion of the court: "The contract between a bank and a depositor is that the former will pay according to the checks of the latter, and when drawn in proper form, the bank is bound to presume that the trustee (if such it knows its depositor to be) is in the course of lawfully performing his duty, and to honor them accordingly. But when against a bank account, designated as one kept by the depositor in a fiduciary character, the bank seeks to assert its lien as a banker for a personal obligation of the depositor, known to have been contracted for his private benefit, it must be held as having notice that the fund represented by the account is not the individual property of the depositor, if it is shown to consist, in whole or in part, of funds held by him in a trust relation."²

"Although the relation between a bank and its depositor is that merely of debtor and creditor, and the balance due on the account is only a debt, yet the question is always open, to whom in equity does it beneficially belong? If the money deposited belongs to a third person, and was held by the depositor in a

¹ National Bank v. Insurance Co.,
104 U. S. 54.

² Id., 64.

fiduciary capacity, its character is not changed by being placed to his credit in his bank account."

. . . . "Ordinarily the banker's lien attaches in favor of the bank upon the securities and moneys of the customer deposited in the usual course of business, for advances which are supposed to be made upon their credit. It attaches to such securities and funds not only against the depositor, but against the unknown equities of all others in interest, unless modified or waived by some agreement, express or implied, or by conduct inconsistent with its assertion. But it cannot be permitted to prevail against the equity of the beneficial owner, of which the bank has notice, either actual or constructive."²

§ 674. Of special classes of corporate creditors, bondholders constitute the most important. Their rights for the most part depend on the terms of the trust deed or mortgage usually made by the corporation to secure the payment of the bonds.³ With notice of the terms of this instrument bondholders are of course affected; and by express stipulation often it is made a part of the bonds themselves. Should, however, provisions in the mortgage or trust deed be inconsistent with those contained in the bonds, the terms of the latter control, since the bonds constitute the principal debt or the best evidence of the corporate obligation, for the payment of which debt or obligation the trust deed or mortgage is but a security.⁴

§ 675. In order that bonds should constitute a lien on the property of a corporation, it is not necessary that a formal

¹ *National Bank v. Insurance Co.*, 104 U. S. 66.

² *Ib.*, 71. See also *Bank of Metropolis v. New England Bank*, 1 How. 234.

³ A law depriving mortgage creditors of their rights against the corporation would impair the obligation of a contract. *Montgomery, etc. R. R. Co. v. Branch*, 59 Ala. 139. But the legislature may constitutionally pass a law providing that unless a creditor of an embarrassed corporation expresses his dissent from measures deemed essen-

tial to the common welfare of the corporation and its creditors, he shall be held to have assented to them. *Union Canal Co. v. Gilfillin*, 93 Pa. St. 95; S. C., *aff'd*, 109 U. S. 401. Compare also *Baltimore v. Baltimore Railroad*, 10 Wall. 543. But a legislature cannot confirm a fraudulent sale of the mortgaged property of a corporation. *White Mountains R. R. Co. v. White Mountains R. R. Co.*, 50 N. H. 50.

⁴ *Railway Co. v. Sprague*, 103 U. S. 756.

mortgage should be given (though, of course, under the various recording acts, a mortgage or trust deed duly executed and recorded is essential to the security of bondholders); for it has been held that bonds issued by a corporation pledging its real and personal property for the payment of the debt and interest, and containing other corresponding stipulations, will be treated by a court of equity as a mortgage, and enforced according to the intention of the contracting parties.¹

§ 676. As against a railroad company and its privies, a railroad mortgage, although given before the road is completed, attaches to the road as fast as built, and to all property covered by the terms of the mortgage as such property comes into the ownership of the railroad company.² And thus a mortgage by a railroad company, which in terms covers "all the following, present, and future to be acquired property," mentioning engines, cars, and machinery, carries not only engines and cars that existed when the mortgage was made, but also such as subsequently take their place or are added by the time of the foreclosure.³ More-

¹ *White Water Valley Canal Co. v. Vallette*, 21 How. 414. See also *Miller v. Rutland, etc. R. R. Co.*, 36 Vt. 452; *In re Strand Music Hall Co.*, 3 De G. J. & S. 147, 158; *Ketchum v. Pacific R. R. Co.*, 4 Dill. 78, 86. Compare *Dillon v. Barnard*, 1 Holmes, 386; *Brunswick and Q. R. R. Co. v. Hughes*, 52 Ga. 557.

² *Galveston Railroad v. Cowdrey*, 11 Wall. 459; *Phila., Wil. and Balto. R. R. Co. v. Woelpper*, 64 Pa. St. 366. See *Pierce v. Emery*, 32 N. H. 484; compare *Dinsmore v. Racine, etc. R. R. Co.*, 12 Wis. 649. See § 817. But see *Henshaw v. Bank of Bellows Falls*, 10 Gray (Mass.), 568; *Howe v. Freeman*, 14 Gray (Mass.), 566; *Mississippi Valley Co. v. Chicago, etc. R. R. Co.*, 58 Miss. 896. Seems special authority is not necessary to enable a railroad company to include

in a mortgage after-acquired property. *City of Quincy v. Chicago, B. and Q. R. R. Co.*, 94 Ill. 537.

³ *Shaw v. Bill*, 95 U. S. 10; *Hamlin v. Jerrard*, 72 Me. 62.

It is held that mortgages of future acquired property are to be liberally construed. *Little Rock, etc. R'y Co. v. Page*, 35 Ark. 304. See *State v. Northern Central Ry. Co.*, 18 Md. 193. But the enumeration of certain classes of "property" may exclude other "property" not mentioned. Thus a railroad company mortgaged its then and after to be acquired "property, that is to say," and then described various species of property mortgaged. It was held that certain municipal bonds issued to aid in building the road, and not embraced in the enumeration of articles mortgaged, did not pass by the use of the general

over, a railroad company owning the whole of a long railroad and all the rolling stock upon it, may assign particular portions of the rolling stock to particular divisions of the road, and mortgage such portions with such divisions respectively. Whether the company has mortgaged its rolling stock in this manner, is a question of intention.¹

§ 677. Terms in securities issued by a railroad or other corporation repugnant to the legislative provisions authorizing the security are void. Thus, a railroad corporation issued its bonds, and mortgaged its property to secure the payment of them, and of the semi-annual instalments of interest thereon, as the same should successively fall due. The statute authorizing the mortgage declared that the bonds should not mature at an earlier period than thirty years. In consequence, a provision in the bonds that, upon a failure to pay any coupon, when presented at the place of payment, and a continued default for six months, the whole sum mentioned in the bond should become due and payable, was held void.²

Invalid provisions in corporate securities.

§ 678. But, although the securities may contain forbidden or unauthorized provisions, courts will refrain from holding void

word "property." *Smith v. McCullough*, 104 U. S. 25. See also *Brainerd v. Peck*, 34 Vt. 496; *Alabama v. Montague*, 117 U. S. 602. Compare *Wilson v. Boyce*, 92 U. S. 320; *Eldridge v. Smith*, 34 Vt. 384.

It has also been held that a railroad corporation cannot include in a mortgage of future to be acquired property, land which, at the time of the mortgage, it had no authority to acquire. *Meyer v. Johnston*, 53 Ala. 237, 331.

¹ *Minnesota Co. v. St. Paul Co.*, 2 Wall. 609; S. C., 6 Wall. 742. A mortgage by a railroad company of "all present and future to be acquired property of the company, including the right of way and land occupied, and all rails and other materials used thereon or procured therefor," includes rolling stock. *Pullan v. Cin-*

cinnati, etc. Air-Line R. R. Co., 4 Biss. 35.

In Illinois, rolling stock is held to be a part of the realty, so as to pass by a conveyance or mortgage of the road. *Michigan Cent. R. R. Co. v. Chicago and M. Lake Shore R. R. Co.*, 1 Ill. App. 399; *Palmer v. Forbes*, 23 Ill. 301; *Hunt v. Bullock*, ib. 320; *Titus v. Mabey*, 25 Ill. 257; *Titus v. Ginheimer*, 27 Ill. 462. This is not the doctrine of other states. *Williamson v. N. J. Southern R. R. Co.*, 29 N. J. Eq. 311, reversing S. C., 28 N. J. Eq. 277; *Hoyle v. Plattsburgh, etc. R. R. Co.*, 54 N. Y. 314; *Coe v. Columbus, etc. R. R. Co.*, 10 Ohio St. 237; see *Boston, Concord, etc. R. Co. v. Gilmore*, 37 N. H. 410.

² *Howell v. Western R. R. Co.*, 94 U. S. 463.

the securities themselves.¹ Thus, a corporation cannot refuse to pay its bonds on the ground that they contain an unauthorized provision to the effect that they may be converted into stock at the option of the holder.²

May not in-
validate the
securities.

§ 679. Bonds of a corporation issued payable to order or to bearer are negotiable.³ And the negotiable quality of such a bond is not impaired by a provision contained in the bond, that it may be "registered and made payable by transfer only on the books of the company."⁴ Accordingly, the rights of a purchaser in good faith are not impaired by equities affecting the title of his vendor.⁵

Corporate
bonds ne-
gotiable.

§ 680. Overdue and unpaid interest coupons do not of themselves make the bond to which they are attached dishonored paper.⁶ When severed from the bond, cou-

Coupons.

¹ See *Howell v. Western R. R. Co.*, *supra*. That some invalid bonds have been issued, does not affect the validity of the mortgage as a security for the other bonds. *Graham v. Boston, etc. R. R. Co.*, 118 U. S. 162. Corporations formed under the New York Manufacturing Companies Act of 1848, may mortgage their property to secure the payment of a debt, but not for the purpose of raising money to carry on their business. A mortgage executed by such corporation to secure bonds used to pay debts, and also to raise money to carry on the business is valid, at least in so far as it secures bonds used to pay the debts of the corporation. *Carpenter v. Black Hawk Gold Mg. Co.*, 65 N. Y. 43.

² *Wood v. Wheelen*, 93 Ill. 153. Compare *Sturges v. Stetson*, 1 Biss. 246.

³ *White v. Vermont, etc. R. R. Co.*, 21 How. 575; *Carr v. Lefevre*, 27 Pa. St. 413; *Mason v. Frick*, 105 Pa. St. 162; *Haven v. Grand Junction R. R. Co.*, 109 Mass. 88; *Morris Canal, etc. Co. v. Fisher*, 9 N. J. Eq. 667; *Brainard v. New York and Har-*

lem R. R. Co., 25 N. Y. 496; see § 326. Compare *Railroad Co. v. Howard*, 7 Wall. 392.

⁴ *Savannah, etc. R. R. Co. v. Lancaster*, 62 Ala. 555. But bonds containing a provision whereby the company reserves the right to pay them off at any time by adding twenty per cent. to the amount of the principal are not negotiable. *Chouteau v. Allen*, 70 Mo. 290, 339.

⁵ *Murray v. Lardner*, 2 Wall. 110. The doctrine of applied notice of a *lis pendens* does not apply to negotiable bonds. See § 327, also *Ex parte Williams*, 18 S. C. 299. As to effect of notice to a trustee for bondholders, see § 814.

A corporation is not liable on its bonds, which are stolen before the certificate of the trustee or the company's seal is affixed, to an innocent holder; the certificate and seal having been forged after the theft. *Maas v. Missouri K. and T. Ry. Co.*, 83 N. Y. 223.

⁶ *Railway Co. v. Sprague*, 103 U. S. 756; *Cromwell v. County of Sac*, 96 U. S. 51. See *National Bank v.*

pons are negotiable and pass by delivery.¹ They then cease to be incidents of the bonds and become independent claims. Consequently, if the bonds are cancelled or paid before maturity, the severed coupons do not thereby lose their negotiable character, nor their ability to support separate actions, and the amount of their face draws interest from the time when it is payable. Statutes of limitation run against coupons, when severed, from their maturity.²

§ 681. The holders of coupons guaranteed by a corporation having general powers to make the guaranty, are not bound to see to the regularity of the exercise of that power.³ And the fact that coupons are made payable at a particular place, does not make a presentation there for payment necessary, before commencing suit on them.⁴ A corporation issuing a coupon bond is in the position of the maker of a promissory note, rather than in that of the drawer of a bill of exchange; and the holder is under no obligation to present the bond or the coupons for payment within a reasonable time.⁵

Rights of
bond-
holders.

§ 682. In a case recently before the Supreme Court of the United States, a railroad mortgage provided that if "default should be made in the payment of any half-year's interest on any of said bonds, and the warrant

Remedies
of bond-
holders.

Kirby, 108 Mass. 497. But see *First Nat. Bank v. County Commissioners*, 14 Minn. 77; *Morton v. New Orleans*, etc. Ry. Co., 79 Ala. 590; see also § 326.

¹ The title to interest coupons passes by delivery. A transfer of possession is presumptively a transfer of title. Especially is this so when the transfer is made to one who is not the debtor and is under no obligation to receive or pay them. But cutting off coupons when due and transferring them to other holders gives to such holders no priority of right over the holders of the bonds from which the coupons have been cut, nor over the subsequently maturing coupons. *Ketchum v. Duncan*, 96 U. S. 657.

² *Clark v. Iowa City*, 20 Wall. 583; *Walnut v. Wade*, 103 U. S. 683;

Ohio v. Frank, ib. 697. See *Gilbert v. Washington City*, etc. R. R. Co., 33 Grat. (Va.) 586; *Whitaker v. Hartford*, etc. R. R. Co., 8 R. I. 47; *Philadelphia and R. R. Co. v. Smith*, 105 Pa. St. 195. Compare *The City v. Lamson*, 9 Wall. 478, in which case it was held a suit on a coupon is barred by a statute of limitations only when suit on the bond is barred. See also § 326.

³ *Connecticut Mut. Life Ins. Co. v. Cleveland*, etc. R. R. Co., 41 Barb. 9. See §§ 205, 328.

⁴ *Walnut v. Wade*, 103 U. S. 683; *Shaw v. Bill*, 95 U. S. 10. See *Alexander v. Atlantic*, etc. R. R. Co., 67 N. C. 198.

⁵ *Williamsport Gas Co. v. Pinkerton*, 95 Pa. St. 62.

or coupon for such interest shall have been presented and its payment demanded, and such default shall have continued six months after such demand, without the consent of the holder of such coupon or bond, then and thereupon the principal of all of the said bonds hereby secured shall be and become immediately due and payable, anything in such bonds to the contrary notwithstanding; and the said [trustee] may so declare the same and notify [the railroad company], and upon the written request of the holders of a majority of the said bonds then outstanding, shall proceed to collect both principal and interest of all such bonds outstanding by foreclosure. . . ." It was held that the written request of a majority of bondholders was a prerequisite to a foreclosure by the trustee. But the court said that any bondholder could have sued in his own name, and could have proceeded to foreclose.¹

¹ *Chicago and Vincennes R. R. Co. v. Fosdick*, 106 U. S. 47. Compare *Howell v. Western R. R. Co.*, 94 U. S. 463; *First National Ins. Co. v. Salisbury*, 130 Mass. 303.

A bondholder under a trust mortgage may sue the railroad on bonds held by him, although the mortgage provides that on the request of the holders of a certain proportion of bonds, more than the plaintiff held, the trustees should sell the property covered by the mortgage. *Phila. and Balto. Cent. R. R. Co. v. Johnson*, 54 Pa. St. 127. See also *Montgomery County Agricultural Society v. Francis*, 103 Pa. St. 378. A bidder at a judicial sale at public auction on foreclosure of a railroad mortgage, whose bid has not been accepted, the sale being adjourned for sufficient cause and finally discontinued, cannot insist on leave to pay his bid and have the sale to him confirmed; although he was the highest bidder and bid enough to cover the mortgage debt. *Blossom v. Railroad Co.*, 3 Wall. 196. A holder of railroad bonds secured by a mortgage under foreclosure has a standing in court

to contest the amount of compensation allowed the trustee under the mortgage. *Williams v. Morgan*, 111 U. S. 684. A board of directors passed a resolution permitting the holders of certain notes of the corporation, secured by a mortgage held by a trustee for the note holders, to convert their notes into stock of the corporation at par, provided, *all* the holders of the notes converted them within ten days: some of the note holders filed their notes for conversion and received certificates of stock. It was held, on subsequent foreclosure of the mortgage, that such of the note holders as had surrendered their notes were entitled to have the foreclosure carried on for them (as well as the rest), not all the note holders having surrendered their notes, and consequently no conversion into stock of any notes having taken place. *Pugh v. Fairmount Mining Co.*, 112 U. S. 238. Taking a pledge of corporate property does not prevent a creditor from suing the corporation or its shareholders, without selling the pledge. *Sonoma Valley Bank v. Hill*, 59 Cal. 107.

CHAPTER XII.

LEGAL RELATIONS BETWEEN SHAREHOLDERS AND OFFICERS OF A CORPORATION.

Effect of investing the officers with authority to manage the corporate enterprise, §§ 683, 684.	should be brought on behalf of all the shareholders, §§ 690, 691.
Right of shareholders that officers shall do no unauthorized acts, § 685.	Directors trustees for <i>all</i> the shareholders, § 692.
Remedy, § 686.	Corporation cannot condone breach of trust, § 693.
Fraudulent or <i>ultra vires</i> acts, § 687.	Responsibility of officers for error; for acts of other officers, § 694.
Shareholders incompetent to bring action against officers until there has been a failure of the corporation to act, § 688.	Acts authorized by shareholders' meetings, § 695.
Competency of shareholders to sue when the corporate management is in the hands of the guilty officers, § 689.	Unconditional right of shareholders to sue for direct injuries, §§ 696, 697.
Corporation a necessary party; action	Limits to the trust relation between shareholders and directors, § 698.
	Directors' right to indemnification, § 699.

§ 683. WHEN a number of persons have combined their property in a joint undertaking, agreeing that the enterprise shall be managed in a certain way, no one of them can at will withdraw from the agreement, or interfere, except as in the agreement provided for, with the management agreed on. Persons who become incorporated agree, that within the fair scope of the purposes of incorporation, the controlling discretion as to the corporate enterprise shall rest with the body corporate acting regularly, and through the will of a majority; and that the ordinary corporate business shall be managed by directors and other officers elected directly or indirectly by the body corporate.¹

Effect of investing the officers with authority to manage the corporate enterprise.

Where, however, as is usual, by the constitution of a corporation the management of the corporate affairs is vested in a

¹ *Dudley v. Kentucky High School*, 9 Bush, 576. See § 553.

board of directors, it would seem to be the right of every shareholder—a right secured to him by the fundamental contract embodied in the corporate constitution—that the ordinary business of the corporation shall be managed and controlled by the board of directors, so long as they act within the scope of their authority and honest discretion, free from the interference of even a majority of shareholders. Under such circumstances the fundamental plan, which every shareholder agreed to, was not that a majority of shareholders, but that the board of directors should, for ordinary purposes, manage and control the affairs of the corporation.

§ 684. Thus, for instance, it has been held that a contract between two connecting railroads for the division of earnings according to the distance which each company should carry the passengers or freight for which the money is paid, is within the discretionary powers of the directors, and its execution cannot be enjoined by a shareholder in one of the companies who holds a majority of its stock, unless he shows a fraudulent purpose on the part of the directors by which he will be injured.¹ Similarly, the Supreme Court of the United States has decided that where the trustees or directors of a railroad company have appealed from a decree, and have directed their counsel to prosecute the appeal, the Supreme Court will not dismiss it on the motion of strangers to the decree, who, since the decree was rendered, have become the owners of the majority of the stock of the corporation. To the directors is, by law, committed the management of the concerns of the corporation; they are its representatives in court, and represent shareholders and creditors. If, in prosecuting an appeal to final judgment, they violate a corporate obligation or their own duty, shareholders must seek a remedy in some court of original jurisdiction.²

§ 685. It is, however, no part of the contract of any shareholder that directors shall do acts unauthorized by the corporate constitution; and it is the right of every shareholder that they shall do no such acts, nor indeed any act beyond their own authority, although within the corporate powers, unless the same is

Right of
share-
holders
that officers
shall do no
unauthor-
ized acts.

¹ *Elkins v. Camden and Atlantic R. Co.*, 36 N. J. Eq. 241.

² *Railway Co. v. Alling*, 99 U. S. 463.

authorized or acquiesced in by the body corporate. Directors about to do an unauthorized act may be restrained no doubt. But how?

§ 686. Unquestionably action to restrain them should be taken by and in the name of the corporation. For the corporation is the direct superior or principal of the board of directors. ^{Remedy.} Moreover, if the unauthorized act of the directors is not improper and fraudulent in itself, and within the scope of the corporate powers, it does not follow that a minority of shareholders have an absolute right that the act should not be done; for it may be that the majority, who have power to do the act in question, approve of it. Under such circumstances, for a minority of shareholders to allege a refusal on the part of the corporation to restrain the act—an essential allegation in a shareholder's bill to enjoin directors—would imply the corporate approval thereof, and demolish the plaintiff's case. Accordingly, a minority of shareholders cannot ordinarily prevent directors from doing any act which, as done by the directors, the majority could competently ratify.¹ The proposed act should be manifestly improper, and the complaint should also show the impracticability of procuring action from the body corporate in time to prevent injury.²

¹ Where to the validity of certain acts, original action on the part of the body corporate is required by statute to be taken in a certain manner, as, *e. g.*, in regard to an increase of the capital stock, it is possible that to validate an unauthorized increase made by the directors, the majority of shareholders would have to go through the prescribed formalities, and that a simple ratification of the increase as made by the directors would not be sufficient.

² In this connection, *Foss v. Harbottle*, 2 Hare, 461, is the leading authority. See § 553 *et seq.*, where the matter is discussed as coming under the right of the corporation or

corporate management, to manage the corporate affairs. Here the matter is spoken of rather with reference to the rights of shareholders against directors personally. See *McNaughton v. Osgood*, 41 Hun (N. Y.), 108.

A bill was filed by shareholders against directors to compel the latter to assign to the corporation a lease which they had taken in their own name, the corporation being made a party defendant. It was held that all the shareholders should also have been made parties, as the corporation had the right to take an assignment or decline it. *Bengley v. Wheeler*, 45 Mich. 493.

§ 687. In many cases, however, the acts of directors which are sought to be restrained are improper, fraudulent, or *ultra vires* acts, which the majority cannot ratify, and which every shareholder has the right to restrain. That such acts should not be done is as much the right of a single shareholder as of a majority of shareholders. Nevertheless, the proper plaintiff in a suit to restrain directors from doing unauthorized acts, or in a suit against them for damages suffered by the corporation, or to compel them to account for illegal profits which they have made, is still the corporation;¹ and a complaint in any such suit, where the corporation is not the complainant, is demurrable, unless it set forth sufficient reasons why the action is not brought by the corporation.²

§ 688. Accordingly, in a suit brought by shareholders to restrain directors or other officers from committing unauthorized acts, the complaint should show—and circumstantially—either that the corporation had been requested to and had refused or failed to take action, or that the corporation is impotent to act for the reason that the guilty officers constitute or control the corporate management and affairs.³ If these facts appear in the complaint, and the complaint further show that the corporation, and the plaintiff's interests therein, would be injured by the commission of the act sought to be prevented, it will be sustained by a court of equity.⁴

¹ *Brown v. Vandyke*, 8 N. J. Eq. 795; *Booth v. Robinson*, 55 Md. 419; *Hedges v. Paquett*, 3 Oreg. 77; *State v. Bank of Louisiana*, 6 La. 745; *Macdougall v. Gardiner*, 45 L. J. Chan. 27.

² *Doud v. Wisconsin, etc. R. Co.*, 65 Wis. 108. See *Black v. Huggins*, 2 Tenn. Ch. 780.

Shareholders cannot maintain a bill for the removal of the treasurer of a corporation unless they have previously applied to the board of directors

for relief. *Tuscaloosa M'f'g Co. v. Cox*, 68 Ala. 71.

³ See §§ 139–142, 553–560. Absence of such allegations, however, cannot be taken advantage of in the first instance in the appellate court. *Bulkley v. Big Muddy Iron Co.*, 77 Mo. 105.

⁴ *Wright v. Oroville M'g Co.*, 40 Cal. 20; *Sears v. Hotchkiss*, 25 Conn. 171; *Pearson v. Tower*, 55 N. H. 215; *Bliss v. Anderson*, 31 Ala. 612. See *Elkins v. Camden and Atlantic*

The same principles apply to actions brought by shareholders against directors, after the commission of the unlawful acts, for damages or to compel the directors to account for profits which they have unlawfully made. The complaint will be sustained if the plaintiff show an injury to himself through injuries to the corporation, and either that the corporation has been requested to sue and has refused or failed;¹ or that it is not in a situation to sue, or is under the control of the guilty officers.² And a shareholder in his complaint in such an action should state particularly the efforts which he has made to prevail on the corporation to sue, so that the court may judge intelligently whether his efforts have been real or simulated.³ In fine, it must be made to appear to the court that it is necessary for the protection of the plaintiff's interests in the corporation that *he* should be allowed to bring the action.

§ 689. The following are a few instances of cases which either hold, or proceed on the assumption, that when it is apparent that the guilty officers constitute the corporate management so as to render a request to the corporation to proceed against them futile, such

Competency of shareholders to sue when the corporate

R. R. Co., 36 N. J. Eq. 467; Cannon v. Trask, L. R. 20 Eq. 669; Watts's Appeal, 78 Pa. St. 370; Sellers v. Phoenix Iron Co., 13 Fed. Rep. 20.

Where, by a statute on failure to publish annual reports the shareholders are made jointly and severally liable for the debts of the corporation, one or more shareholders may have a *mandamus* to compel the officers to publish the reports. Smith v. Steele, 8 Neb. 115. So a shareholder may have a *mandamus* to compel the officers to hold the annual election for trustees. People v. Cummings, 72 N. Y. 433.

¹ Greaves v. Gouge, 69 N. Y. 154; Smith v. Poor, 40 Me. 415; Booth v. Robinson, 55 Md. 419; Brewer v. Boston Theatre, 104 Mass. 378; Evans v. Brandon, 53 Tex. 56; Cogswell v. Bull, 39 Cal. 320; Hazard v.

Durant, 11 R. I. 195. Compare Heath v. Erie R'y Co., 8 Blatchf. 347.

² Brewer v. Boston Theatre, 104 Mass. 378; Rogers v. Lafayette Agricultural Works, 52 Ind. 296; Carter v. Ford Glass Co., 85 Ind. 180; Pond v. Vermont Valley R. R. Co., 12 Blatchf. 280; Heath v. Erie R'y Co., 8 Blatchf. 347; Ryan v. Leavenworth, etc. R'y Co., 21 Kan. 365; Peabody v. Flint, 6 Allen, 52; Mussina v. Goldthwaite, 34 Tex. 125; Jones v. Johnson, 10 Bush (Ky.), 649; Hilles v. Parrish, 14 N. J. Eq. 380; Booth v. Robinson, 55 Md. 419; Neall v. Hill, 16 Cal. 145; Deaderick v. Wilson, 8 Bax. (Tenn.) 108. See Watts's Appeal, 78 Pa. St. 370; Brown v. Vandyke, 8 N. J. Eq. 795.

³ Dannmeyer v. Coleman, 11 Fed. Rep. 97. See § 140.

manage-
ment is in
the hands
of the
guilty
officers.

request need not be made by shareholders before commencing suit against them.¹

An action will lie in favor of a shareholder against the president of a corporation, without previous demand on the directors for relief, when the following facts appear from the complaint: that the corporation has made profits; that the president does not allow them to appear on the books of the corporation; that he is largely indebted to the corporation, and has received, but not accounted for, its emoluments; that the majority of the directors are his tools, and have surrendered to him the control of the corporate affairs.²

Where a member of the board of directors, who is also secretary of the board and treasurer of the corporation, presents a bill for extra compensation as secretary and treasurer, he is disqualified from acting as a director on the auditing of the bill; and if the interested director is needed to make a quorum, and by the aid of his own vote the bill is approved of, any shareholder may sue for himself and other shareholders to prevent its payment and to set aside the proceedings.³

Directors of a national bank are liable to shareholders for losses sustained by it through their gross negligence and inattention to duty. If the receiver of the bank when insolvent, himself one of the guilty directors, refuses to sue, a shareholder may, on behalf of himself and all other shareholders, sue the directors for damages, making the receiver and the bank parties. The complaint need not allege a direction to sue from the controller of the currency, or a refusal on his part to direct the receiver to sue; and the action may be brought in a state court.⁴ In such an action the statute of limitations affecting equitable actions generally applies.⁵

¹ Other cases are cited in the last note but one, many of which are stated more at length elsewhere. See, especially, *Brewer v. Boston Theatre*, § 560.

² *Rogers v. Lafayette Agricultural Works*, 52 Ind. 296.

³ *Butts v. Wood*, 37 N. Y. 317.

⁴ *Brinckerhoff v. Bostwick*, 88 N. Y. 52; reversing S. C., 23 Hun. 237. See also *Merchants and Planters' Line v. Waganer*, 71 Ala. 581; *Kelsey v. Sargent*, 40 Hun (N. Y.), 150.

⁵ *Brinckerhoff v. Bostwick*, 99 N. Y. 185.

§ 690. In all cases where shareholders bring suit against directors and other officers, either to restrain them from improper and unauthorized acts, or to compel them to account for illegal profits which they have made, or when the suit is simply to recover damages for injuries accruing to the corporate property through their wrongful or negligent acts, it is essential that the corporation be made a party defendant.¹ Unless all the shareholders join as plaintiffs, the action should be brought on behalf of all; or, at least, of all who are willing to join in defraying its expenses.² And a court of equity is the appropriate tribunal.³

Corporation a necessary party; action should be brought on behalf of all the shareholders.

As in such cases the injury wrought by the misfeasance of the officers is common to all shareholders, so in the interests of all should the suit be brought. And thus it has been held that a single shareholder cannot maintain a separate action at law against directors for damages sustained by reason of their negligence, which had rendered his shares worthless. His action should be brought in a form to protect the interests of the corporation as trustee for all its shareholders and creditors.⁴

¹ *Greaves v. Gouge*, 69 N. Y. 154; *Cunningham v. Pell*, 5 Paige (N. Y.), 607; *Charleston Ins., etc. Co. v. Sebring*, 5 Rich. Eq. (S. C.) 342; *Sears v. Hotchkiss*, 25 Conn. 171; *Black v. Huggins*, 2 Tenn. Ch. 780; *Robinson v. Smith*, 3 Paige (N. Y.), 222; *Davenport v. Dows*, 18 Wall. 626.

Where shareholders pass a resolution to cease to do business, and place all the assets of the corporation in the hands of one of its officers, to be converted into money for distribution among the shareholders after paying the corporate debts, the corporation is still a necessary party to a bill filed by a shareholder against the officer for an account and settlement of the shareholder's interest. *Young v. Moses*, 53 Ga. 328. So when the corporation

is in the hands of a receiver, he as well as it is a necessary party defendant. *Brinckerhoff v. Bostwick*, 88 N. Y. 52.

² *Greaves v. Gouge*, 69 N. Y. 154; *Brewer v. Boston Theatre*, 104 Mass. 378; *Robinson v. Smith*, 3 Paige (N. Y.), 222; *Davenport v. Dows*, 18 Wall. 626. See *Rogers v. Lafayette Agricultural Works*, 52 Ind. 296.

³ *Hodges v. New England Screw Co.*, 1 R. I. 312; S. C., 3 R. I. 9; see *Smith v. Hurd*, 12 Metc. 371; *Allen v. Curtis*, 26 Conn. 456.

⁴ *Craig v. Gregg*, 83 Pa. St. 19; *Gardiner v. Pollard*, 10 Bos. (N. Y.) 674. See also *Evans v. Brandon*, 53 Tex. 56. Compare *Gaffney v. Colvill*, 6 Hill, 567; *Oliphant v. Woodburn, etc. Co.*, 63 Iowa, 332.

§ 691. A distinction has been taken¹ which has not met with continuing approval; namely, that while a shareholder may sue directors for damages arising to him through a breach of trust on their part, he may not bring a suit in which a judgment would in any way control the corporate action. The distinction seems badly taken, for if the corporation refuses or fails to act, it will often be that only through controlling the corporate action by the aid of a court of equity can a shareholder adequately protect his interests.

§ 692. Although it is to the body corporate that directors are immediately accountable, and actions can be sustained against them by a shareholder for abuse of their trust only under the conditions mentioned, none the less do directors and other corporate officers hold their powers in trust for all the shareholders, minority as well as majority;² and the primary reason why a single shareholder cannot always bring suit against the guilty officers immediately is not the inconvenience which a multiplicity of suits might cause the latter, but rather the right of the corporation to control the actions of its appointees and bring them to account. Accordingly, from the restrictions on the right of shareholders to bring suits against corporate officers for a breach of duty, it is not to be implied that directors and other officers do not owe to every shareholder the substantial duties which they owe immediately to the corporation. These restrictions are only in respect of the manner of enforcing their duties; and the shareholders are the real beneficiaries.

¹ *Hodges v. New England Screw Co.*, 1 R. I. 312.

² *Harris v. North Devon R'y Co.*, 20 Beav. 384; *Richards v. New Hampshire Ins. Co.*, 43 N. H. 263.

Directors can make no disposition of the corporate funds which will not enure to the equal [proportionate] benefit of shareholders. *Hale v. Republican River Bridge Co.*, 8 Kan. 466.

In *Richardson v. Larpent*, 2 Y. &

C. N. R. 507, the bill was dismissed because shareholders, holding views opposed to the plaintiff, were not made parties to the suit, although the defendant directors held the views of such shareholders. Bruce, V. C., saying (p. 514), "Directors are officially obliged to have an equal mind towards the shareholders, and cannot properly be considered as representing an opposition."

§ 693. Thus, it may be said that the officers of a corporation owe to the shareholders all the duties which they owe to the body corporate; and the rules governing the liability^a of officers to the body corporate also govern their substantial liability to the shareholders. Moreover, it is beyond the powers of the corporation to condone gratuitously, so as to conclude non-consenting shareholders, a breach of trust on the part of directors, whereby the assets of the corporation have been wasted or the corporate interests injured.¹ Accordingly, for every breach of trust on the part of the officers of a corporation, whether the same consist in fraudulent or unauthorized acts or in gross negligence,² the guilty officers are liable to the individual shareholders in damages, or to account for unlawful profits made by them.³ And to enforce this liability, actions may be brought by the latter under the conditions heretofore discussed.⁴

Corporation cannot condone breach of trust.

§ 694. As corporate officers acting in good faith within their authority are not liable to the corporation for a mere mistake in judgment,⁵ so, for such mistakes, they will not be liable to individual shareholders.⁶ Neither will they be liable to shareholders for the frauds of other officers under circumstances which do not render them liable to the corporation.⁷ But, whenever directors

Responsibility of officers for errors; for acts of other officers.

¹ Hazard v. Durant, 11 R. I. 195.

² Brinckerhoff v. Bostwick, 88 N. Y. 52.

³ Ryan v. Leavenworth, etc. R'y Co., 21 Kans. 365; Farmers', etc. Bank v. Downey, 53 Cal. 466; Koehler v. Black River Falls Iron Co., 2 Black 715.

Directors will be liable to shareholders if they fraudulently mismanage the corporate affairs in the interests of a rival corporation. Booth v. Robinson, 55 Md. 419.

⁴ Shareholders may, however, lose their right to object by acquiescence or a long delay; and they are chargeable with knowledge of the records of

the corporation. Kitchen v. St. Louis, etc. R'y Co., 69 Mo. 224; see Watts's Appeal, 78 Pa. St. 370.

⁵ See § 620.

⁶ Smith v. Prattville M'fg Co., 29 Ala. 503; Watts's Appeal, 78 Pa. St. 370; Booth v. Robinson, 55 Md. 419.

⁷ Dunn v. Kyle, 14 Bush (Ky.), 134. See §§ 624-626. A director is not liable to a shareholder for misrepresentations in the articles of association made before the election of the board, of which he was a member; and a person cannot maintain an action against directors for the violation of a statute and the consequent depreciation of the stock, when the acts com-

incur liability to the corporation for the frauds of other officers which the negligence of the directors renders possible, the directors will be liable to the shareholders if the corporation fails to bring suit against them.¹

§ 695. Directors have been held not to be liable to shareholders for improper or illegal acts which are authorized by a shareholders' meeting.² And a bill in equity filed by shareholders against directors alleging illegal acts on the part of the latter, is demurrable when one of the complainants is a director who participated in the alleged acts.³

§ 696. When an injury to a shareholder is not the result of a misapplication of the corporate funds by reason of which all shareholders suffer alike; but is an injury done by corporate officers to the shareholder directly, the shareholder may sue at once on his own behalf; for he is the only person injured, and in respect of such injuries he is not held to have confided the protection of his interests to the body corporate.⁴ Accordingly, when a person is induced through the fraudulent misrepresentations of

plained of were committed before he became a shareholder. *Mabey v. Adams*, 3 Bos. (N. Y.) 346.

¹ *Ackerman v. Halsey*, 37 N. J. Eq. 356; *aff'd* 38 N. J. Eq. 501.

² *International, etc. R. R. Co. v. Bremond*, 53 Tex. 96. See also *Overend v. Gurney*, L. R. 4 Ch. 701; *S. C.*, *sub nom.* *Overend & Gurney Co. v. Gibb*, L. R. 5 H. L. 480. Compare *Dederick v. Wilson*, 8 Bax. (Tenn.), 108.

³ *Baird v. Midvale Steel Works*, 12 Phila. (Pa.) 255.

⁴ The treasurer of a corporation who holds money to pay a dividend which has been declared, and refuses to pay the dividend on certain shares, claiming to be the owner of them himself, is liable personally for the amount of the dividend, to the real owner in an action of assumpsit for money had and

received. *Williams v. Fullerton*, 20 Vt. 346. When there are two classes of shareholders, one whose dividends are to be deferred for a number of years, and directors pay to the other class dividends out of the capital of the company, the directors may be personally liable to make up the sum, in the interests of the deferred shareholders. *Salisbury v. Metropolitan R'y Co.*, 22 L. T. N. S. 839.

Some directors attempted to purchase on behalf of their bank its own stock. This they had no power to do, and the bank repudiated the transaction. It was held that the vendor could not sue the directors, who had made no misrepresentations and whose want of power was a matter of law, as open to the knowledge of the plaintiff as to themselves. *Abelas v. Cochran*, 22 Kan. 405.

directors to purchase shares, he may sue them immediately for the damages arising from the wrong done him.¹ Likewise, when directors make a fraudulent overissue of stock, any one purchasing such shares on the faith of their having been lawfully issued may recover from the directors the damages sustained by him.²

§ 697. If confidential agents of a company conspire to depress the selling price of the shares by a system of false accounts and concealments, in order that they may purchase shares at less than the real value, and they do purchase the shares of a holder at less than the shares are worth, the holder may have the sale set aside with an accounting for dividends received by them, or may hold the agents for the difference between the value of the shares and what they paid.³ Where, however, the defendant with other directors of a corporation, made an assessment on its stock, upon which but a small proportion was paid, and threatened to make further assessments for the purposes of the corporation, a course of action which induced the plaintiff to sell his shares to the defendant, it was held that there was no such fraud in the matter as would warrant setting the sale aside.⁴

§ 698. The trust relation between shareholders and directors extends only to matters relating to the management of the corporate business. Accordingly, rules applicable to transactions between a trustee and his *cestui que trust* do not extend to a purchase of shares made by a director from a shareholder, and in the absence of actual fraudulent misrepresentations, such a sale will be upheld, provided the director does not intentionally and fraudulently divert or prevent the vendor from making inquiries into the condition of the corporate affairs.⁵

Limits to the trust relation between shareholders and directors.

¹ Cole v. Cassidy, 138 Mass. 437; Davidson v. Tulloch, 3 Macq. 783; Paddock v. Fletcher, 42 Vt. 389; Cazeaux v. Mali, 25 Barb. 578; Morgan v. Skiddy, 62 N. Y. 319; Bale v. Cleland, 4 Foss. & Fin. 117. Compare Mabey v. Adams, 3 Bos. (N. Y.) 346.

² Bruff v. Mali, 36 N. Y. 200; Shotwell v. Mali, 38 Barb. 445.

But an assignee of shares cannot sue the transfer agent for improperly refusing to register him; but must sue the corporation. Denny v. Manhattan Co., 2 Denio (N. Y.), 115.

³ Walsham v. Stainton, 1 De G. J. & S. 678.

⁴ Grant v. Attrill, 11 Fed. Rep. 469.

⁵ Carpenter v. Danforth, 52 Barb.

This rule, regarding the purchase of shares by an officer, was applied under the following circumstances. The defendant, who was the president and a director of a railroad company, knowing by reason of his official position that the true value of its stock was largely in excess of the selling price, purchased the shares of a non-official shareholder for less than their real value. The court held that the defendant was under no duty to disclose to the shareholder matters affecting the value of the shares, which were not matters of general opinion and could not have been found out by the shareholder. The fact known to the defendant and not to the plaintiff, was that the former was about to consummate a sale of the road which was likely to enhance, and when effected did greatly enhance, the value of the stock.¹

§ 699. If directors expend money, and incur personal liability for purposes not within their authority, yet the shareholders, knowing the circumstances, acquiesce, and receive the benefit of their acts, the directors will, as against the shareholders, be entitled to indemnity from the corporate funds.² And if shareholders neglect to attend corporate meetings where they know such matters are to be discussed, they will not be permitted to take advantage of their ignorance.³ But where by reason of certain defaults the officers of a corporation have been compelled to pay its debts, they cannot obtain contributions from the shareholders, whom the same statute rendered liable after the property of the officers had been exhausted.⁴

Directors' right to indemnification.

581; *Deaderick v. Wilson*, 8 Bax. (Tenn.) 108; *Commissioners of Tippecanoe County v. Reynolds*, 44 Ind. 509.

¹ *Commissioners of Tippecanoe Co. v. Reynolds*, 44 Ind. 509, Downey, C. J., dissenting. The transaction which in this case was allowed to stand seems to the writer to have been eminently unfair, and indeed a rule—for which this decision is certainly authority—that directors in their dealings with shareholders are entitled to

take advantage of their knowledge of facts not known to the latter, but which the directors are acquainted with by reason of their official position, seems of questionable propriety.

² *Ex parte Chippendale*, 4 De G. M. & G. 19; § 645.

³ See *Turquand v. Marshall*, L. R. 4 Ch. 376; *In re British, etc. Assur. Soc., Lane's Case*, 1 De G. J. & S. 504.

⁴ *Stone v. Fenno*, 6 Allen, 579.

CHAPTER XIII.

LEGAL RELATIONS BETWEEN SHAREHOLDERS AND CREDITORS OF A CORPORATION.

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| <p>Rights of creditors in absence of statutory liability, § 700.</p> <p>Liability incurred by subscribing. Conditions, § 701.</p> <p>Liability in respect of shares issued for property, § 702.</p> <p>Creditors' remedies, § 703.</p> <p>Joinder of parties in creditors' bills, §§ 704-706.</p> <p>Appointment of receiver. Assignee in bankruptcy, § 707.</p> <p>Rights of creditors against shareholders improperly withdrawing corporate funds, § 708.</p> <p>Shareholders, in what respects trustees for creditors, §§ 709-711.</p> <p>Classes of statutes imposing personal liability, § 712.</p> <p>Return of unsatisfied execution against the corporation, § 713.</p> <p>Nature of statutory liability, §§ 714-716.</p> <p>Shareholders not <i>left</i>, but <i>made</i> liable, § 717.</p> <p>To what shareholders statutory liability attaches, §§ 718-720.</p> <p>Creditors the proper parties to sue, § 721.</p> <p>Necessary averments in pleading, §§ 722, 723.</p> <p>Performance by creditor of conditions precedent, § 724.</p> <p>Joinder of parties, § 725.</p> <p>Distinction, § 726.</p> <p>Liability of shareholders in national banks, § 727.</p> <p>Extinguishment of liability, § 728.</p> | <p>Set-off. Unpaid subscriptions, § 729.</p> <p>Set-off. Dividends improperly received, § 730.</p> <p>Set-off. Statutory liability, §§ 731, 732.</p> <p>When shareholder, who is also a creditor, cannot sue another shareholder at law, § 733.</p> <p>Liability for debts of a particular class. "Debts," § 734.</p> <p>Waiver or repeal of statutory liability. Substantial compliance with statute, § 735.</p> <p>Statute of limitations, § 736.</p> <p>Effect of judgment against corporation, § 737.</p> <p>Shareholders cannot deny corporate existence, § 738.</p> <p>Nor can the creditor ordinarily, § 739.</p> <p>Who are shareholders as to creditors, § 740.</p> <p>Transferee of shares as collateral security, § 741.</p> <p>Real owner of shares liable, § 742.</p> <p>Rationale, § 743.</p> <p>Fraud, when no defence, § 744.</p> <p>Releases, no defence, § 745.</p> <p>Compromises: forfeitures, § 746.</p> <p>Effect of transfers of shares. Transfers to the corporation, § 747.</p> <p>Irregular transfers, § 748.</p> <p>Transfers in fraud of creditors, § 749.</p> <p>Relations between shareholders and creditors on winding up. Dividends, § 750.</p> <p>On dissolution, § 751.</p> |
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Rights of
creditors in
absence of
statutory
liability.

§ 700. When, according to the constitution of a corporation, liability for corporate indebtedness is not extended beyond the corporate funds properly so called, that is, not beyond the capital named in the charter or articles of association, paid up or agreed to be paid up, and to be used in the corporate business, it is almost an identical proposition to say that the shareholders, provided they honestly pay what they have subscribed, are not personally liable to creditors of the corporation.¹ When such is the constitution of a corporation, creditors have but two general and comprehensive rights as against shareholders: the one right, that each shareholder, unless cash in amount or property in value equal to the par value of his shares has been paid to the corporation on account of them, shall contribute to the corporate funds the amount unpaid on his shares when necessary to meet the corporate indebtedness;² the other right, that shareholders shall not, to the injury of creditors, divert the funds of the corporation from their proper function of discharging the corporate indebtedness. Whatever rights against shareholders in a corporation with a constitution of this nature creditors may have, are incidental to these two main rights.

Liability
incurred by
subscribing.
Con-
ditions.

§ 701. By subscribing for shares in the capital stock of a corporation, subscribers, even without an express promise to pay, are held impliedly to agree to pay to the corporation the par value of the shares subscribed for by them respectively.³ However, as it is

¹ See *Seymour v. Sturges*, 26 N. Y. 134. A statute prescribing that no shareholder shall be liable to creditors of the corporation for more than the amount subscribed by him is declaratory of the common law. *Walker v. Lewis*, 49 Tex. 123.

² This right of creditors, or liability of shareholders, is sometimes expressed by statute. (See N. Y. Rev. Stat. chap. 18, tit. iii. § 1, par. 5); *Morgan v. New York and Albany R. R. Co.*, 10 Paige (N. Y.), 290.

³ See § 513.

The original holder of stock in a

corporation is liable for unpaid instalments of stock without an express promise to pay them, and a contract made by him with the corporation or its agents, limiting his liability therefor, is void as to creditors of the company and its assignee in bankruptcy who represents them. *Upton v. Tribilcock*, 91 U. S. 45; *Tuckerman v. Brown*, 33 N. Y. 297; *Jewell v. Rock River Paper Co.*, 101 Ill. 57; *Union Mut. Life Ins. Co. v. Frearstone M'fg Co.*, 97 Ill. 537; *Keystone Bridge Co. v. Barstow*, 8 Mo. App. 494; *Wight Co. v. Steinkemeyer*, 6 Mo. App. 574;

the law that when a certain amount of stock is mentioned in the charter or articles of incorporation, a contract to subscribe cannot be enforced by the corporation before the total amount is subscribed, so creditors cannot compel a subscriber to pay up his subscription when the same implied condition is unfulfilled and the subscriber has done nothing to estop himself from setting up such defence.¹ But a subscriber does estop himself by paying a call and acting as a shareholder.² The capital stock, whether actually paid up or subject to call, constitutes the primary fund to be applied in furthering the objects of incorporation. It is the fund which subscribers are bound to contribute, and which creditors may rely on for the payment of their claims.³ It need not be altogether cash, but may consist

Goodwin v. McGehee, 15 Ala. 232. The charter of a trust company provided: "If at any time the capital stock paid into said corporation shall be impaired by losses or otherwise, the directors shall forthwith repair the same by assessment." The company being insolvent and in the hands of a receiver, it was held that a personal liability was not imposed on the shareholders, and that they could not be assessed to pay creditors, and that the purpose of said provision was to prevent the continuance of business with impaired capital. *Dewey v. St. Albans Trust Co.*, 57 Vt. 332.

The shareholders of a corporation who were under no personal liability to its creditors, at a time when the corporation was insolvent, made an agreement to pay the treasurer "the sums set opposite our names, respectively, for the purpose of liquidating the debt against said association." All but one paid the amount, and the business was continued three years. It was held that an action of assumpsit, in the name of the treasurer, could be maintained on behalf of those who

were creditors at the time of the above agreement, the corporation having ceased to do business, and transferred its assets to its creditors. *Haskell v. Oak*, 75 Me. 519. A corporation was organized, the members agreeing that its liabilities should not exceed an amount much less than its nominal capital stock; they then distributed its capital stock among themselves, paying for it only a small fraction of its face. *Held*, a shareholder who was a party to the original agreement could not recover against other shareholders for debts owing him by the corporation beyond the limited amount; but *seems* an outside creditor could. *Halderman v. Ainslie*, 82 Ky. 395.

¹ *Temple v. Lemon*, 112 Ill. 51. See § 518. But the subscriber may estop himself by delay from insisting (as against creditors) on the condition. *Lee v. Imbrie*, 13 Oreg. 510.

² *Cornell and Michler's Appeal*, 114 Pa. St. 153.

³ See §§ 654, 655.

When sued by a creditor a subscriber cannot plead an agreement not contained on the face of the subscrip-

partly in buildings, plant, and properties. Accordingly, a shareholder may pay for his shares in property or even in services, provided such property or services be fairly worth the par value of the capital stock received as fully paid up in return.¹

§ 702. To issue shares as fully paid up for property known to the corporation and the shareholder receiving them to be materially below their par value, is a fraud on creditors, for whose benefit the shareholder to whom the shares are issued may be compelled to make up the difference.² This rule is not affected by the facts that the corporation was insolvent when the shares were issued, and that they were issued in payment of a debt owed by it.³ If, however, shares are issued as fully paid up, when in fact the corporation has never received the par value of them, creditors cannot compel a person who buys them in good faith as full

tion, that the subscription was to be paid only under certain conditions. *Hickman v. Wilson*, 104 Ill. 54. See § 521.

¹ *Coit v. Gold Amalgamating Co.*, 119 U. S. 343. See § 545.

But a subscriber cannot as against creditors set up a collateral agreement that his subscription was to be paid in land which the corporation had no authority to acquire. *Noble v. Calender*, 20 Ohio St. 199. Compare *In re Glen Iron Works*, *Wilbur v. Stockholders*, 13 Phila. (Pa.) 479; S. C., 18 Bankr. Reg. 178. "The public has a right to assume, where the stock of a company has all been issued as full-paid stock, that it has been paid for in full in money, or in property at a fair value." *Goff v. Hawk-eye Pump, etc. Co.*, 62 Iowa, 691, 694, opinion of court per Adams, J. Where a corporation issued all its stock for a patent which turned out worthless, the stockholders were held

liable to creditors. *Chisholm Bros. v. Forney*, 65 Iowa, 333.

² *Jackson v. Traer*, 64 Iowa, 469; *Freeman v. Stine*, 15 Phila. (Penn.) 37; *Crawford v. Rohrer*, 59 Md. 599; *Osgood v. King*, 42 Iowa, 478; see also *Wetherbee v. Baker*, 35 N. J. Eq. 501. But see the remarkable decision, *In re South Mountain Consolidated M'g Co.*, 14 Fed. Rep. 347.

Where stock is issued in good faith for property supposed to equal in value the amount of stock issued for it, the subscriber will not be liable to creditors because subsequent events show that the property was worth less. *Coit v. Gold Amalgamating Co.*, 14 Fed. Rep. 12; S. C. aff'd 119 U. S. 343; *Brant v. Ehlen*, 59 Md. 1. See *Coffin v. Ransdell*, 110 Ind. 417, and § 723.

³ *Jackson v. Traer*, 64 Iowa, 469. In this case \$350,000 of stock were issued in payment of a debt of \$70,000. Contra, *Clark v. Bever*, 31 Fed. Rep. 670.

paid, to pay the difference between their par value and the value of whatever property was given for them originally.¹ Though very likely the creditors could hold the original subscriber who took the shares as fully paid up, knowing them not to be so, liable for such difference,² or for the difference between what he gave and what he received for them.³

§ 703. Creditors in order to enforce their main right to have the nominal value of the capital stock actually paid in, have the subsidiary right to compel the directors to make calls;⁴ or creditors may themselves bring a

Creditors' remedies.

¹ *Brant v. Ehlen*, 59 Md. 1; *Phelan v. Hazard*, 5 Dill. 45; *Stacy v. Little Rock, etc. R. R. Co.*, ib. 348; *Foreman v. Bigelow*, 4 Cliff. 508; *Erskine v. Loewenstein*, 82 Mo. 301; *Johnson v. Lullman*, 15 Mo. App. 55; S. C., 88 Mo. 567; *Keystone Bridge Co. v. McCluney*, 8 Mo. App. 496; see *Waterhouse v. Jamieson*, L. R. 2 H. L. Sc. 29. Compare *Peck v. Coalfield Coal Co.*, 11 Ill. App. 88; *Railroad Co. v. Howard*, 7 Wall. 392. See § 545.

² See *Boyton v. Hatch*, 47 N. Y. 225; *Tallmadge v. Fishkill Iron Co.*, 4 Barb. 382; *Pell's Case*, L. R. 5 Ch. 11.

³ *Eyerman v. Kriekhaus*, 7 Mo. App. 455. *Christensen v. Eno*, 106 N. Y. 97, appears to hold that a corporation may present shares of its stock to shareholders, and that on its subsequent insolvency creditors cannot compel shareholders who have received shares as a gratuity to pay up the par value thereof. Compare *Clark v. Bever*, 31 Fed. Rep. 670.

⁴ See § 661.

In the ordinary case of a solvent corporation there is no liability on shareholders to pay in the capital until an assessment is levied by the proper corporate authorities; but when the corporation becomes insolvent, espe-

cially if it ceases to be a going concern, this condition precedent ceases to exist, and payment is compellable at the suit of creditors, although no assessment has been made. *Hatch v. Dana*, 101 U. S. 205; *Wilbur, Assignee, v. Stockholders, In re Glen Iron Works*, 18 Bankr. Reg. 178; S. C., 13 Phila. 479; *Holmes v. Sherwood*, 3 McCrary, 405; *Crawford v. Rohrer*, 59 Md. 599. Compare *Seymour v. Sturges*, 26 N. Y. 134.

Unpaid stock "in cases of insolvency is due as an entirety; it is due to the aggregate of the creditors; only so much is due as is requisite to discharge the indebtedness of the corporation after all other assets have been thereto applied; as a necessary consequent there must be an account of debts, assets, and unpaid capital taken; when such account has been taken, and the amount required from each stockholder has been ascertained, an assessment ordering the payment of such proportionate amount by each may be made by a court of competent jurisdiction in a proceeding in which the corporation and the stockholders should be made defendants.

"I consider it as the clear result of the authorities that, except in cases where the corporate authorities have themselves made calls which are au-

bill in equity against the delinquent shareholders.¹ But a creditor cannot sustain a bill against shareholders for satisfaction of his claim from their unpaid subscriptions until he has exhausted his legal remedies against the corporation and its property.² Though it would seem that this last rule is inapplicable to creditors of a dissolved corporation who can obtain no judgment at law against it.³

§ 704. A creditor suing for satisfaction of his debt may properly, and, according to the majority of decisions, must sue on behalf of himself and all other creditors who are willing to join. For the unpaid subscriptions constitute a fund for the benefit of all the creditors.⁴ In such an action it is proper to join all the share-

Joinder of parties in creditors' bills.

thorized by the subscription contracts, there is absolutely no liability of any kind whatever, on the part of the stockholder to pay any part of his unpaid capital, except under and by force of an assessment made as above stated." Bunn's Appeal (or Lane's Appeal), 105 Pa. St. 49, 67, per Green, J., giving opinion of the Supreme Court of Pennsylvania. This case disapproves *In re Glen Iron Works*, 13 Weekly Notes, 387; S. C., 13 Phila. 479. Consequently, on the insolvency of a corporation, unpaid and uncalled amounts due upon the capital stock cannot be attached by a judgment creditor of the corporation by means of an attachment execution. Bunn's Appeal, *supra*.

¹ Gaff v. Fleisher, 33 Ohio St. 107; Harmon v. Page, 62 Cal. 448; Lane's Appeal, 105 Pa. St. 49; Allen v. Montgomery R. R. Co., 11 Ala. 437, 449; Hightower v. Thornton, 8 Ga. 486, 504; see Jones v. Jarman, 34 Ark. 323; Haslett v. Wotherspoon, 1 Strobb. Eq. (S. C.) 209. A shareholder cannot plead against creditors, that interest on instalments already paid in, has not been paid him by the

corporation as promised. Wood v. Pearce, 2 Disney (Ohio), 411. See also cases in succeeding notes. But an action *at law* does not lie by a creditor against a shareholder for unpaid subscriptions. Patterson v. Lynde, 106 U. S. 519. See Bunn's Appeal, *supra*. A stockholder cannot be garnished on his unpaid subscription by a creditor of the corporation, when no call has been made. McKelvey v. Crockett, 18 Nev. 238. As to the assignment by the corporation of unpaid subscriptions, see §§ 543, 707.

² Terry v. Anderson, 95 U. S. 628, 636; Sturges v. Vanderbilt, 73 N. Y. 384; Blake v. Hinkle, 10 Yerger (Tenn.), 218. See Hatch v. Dana, 101 U. S. 205; Marsh v. Burroughs, 1 Woods, 463; Remington v. Samana Bay Co., 140 Mass. 494. As to the effect in such a suit of a judgment against a corporation, see § 737.

³ Terry v. Anderson, *supra*; compare Sturges v. Vanderbilt, *supra*; Remington v. Samana Bay Co., 140 Mass. 494.

⁴ See Dabney v. Bank of South Carolina, 3 S. C. 124; Sawyer v. Hoag, 17 Wall. 610; Hickling v.

holders as defendants; and if the latter are too numerous to be joined, or if some of them are unknown to the plaintiff, or insolvent, or beyond the jurisdiction of the court, the creditors' bill should contain allegations to this effect.¹ The corporation should also be made a party defendant.²

§ 705. The corporation being insolvent, no doubt any creditor not made a party to the bill has a right to come in and insist on a ratable distribution of the corporate assets, which include unpaid subscriptions.³ And a creditor's bill that is properly framed will be in a form to enable any creditor to join.⁴ It would, however, work hardship if a creditor who sues in a court of equity to reach assets of the corporation which he cannot subject to his claim in an action at law, were in all cases obliged to make all the shareholders parties, or even to bring his suit on behalf of all the creditors. To insist on this would practically force a creditor seeking such equitable relief to bring a bill for the winding up of the corporation; which is certainly not incumbent on him.⁵

Thus, in *Marsh v. Burroughs*,⁶ a bill was brought by certain judgment creditors of a bank against a portion of the shareholders, to compel them to satisfy the plaintiffs' judgments from the unpaid subscriptions due on the defendants' shares. The bill alleged that the stock of the bank was divided into twenty thousand shares, held by a great number of shareholders in different states, some of whom were insolvent. Although

Wilson, 104 Ill. 54; *Lane's Appeal*, 105 Pa. St. 49; *Brundage v. Monumental Gold, etc. M'g Co.*, 12 Oreg. 322; *Patterson v. Lynde*, 112 Ill. 196. This rule holds good though the corporation be a foreign corporation. *Ib.*

¹ *Adler v. Milwaukee Patent Brick M'f'g Co.*, 13 Wis. 57; *Vick v. Lane*, 56 Miss. 681; *Wetherbee v. Baker*, 35 N. J. Eq. 501; *Holmes v. Sherwood*, 3 McCrary, 405; *Bronson v. Insurance Co.*, 85 N. C. 411. See *Hadley v. Russell*, 40 N. H. 109; *Erickson v. Nesmith*, 46 N. H. 371.

² *Wetherbee v. Baker*, 35 N. J. Eq. 501; *Perkins v. Sanders*, 56 Miss.

733; *Holmes v. Sherwood*, 3 McCrary, 405; *Patterson v. Lynde*, 112 Ill. 196.

³ See *Pfohl v. Simpson*, 74 N. Y. 137; *Marr v. Bank of West Tennessee*, 4 Coldw. (Tenn.) 471; *Adler v. Milwaukee Patent Brick M'f'g Co.*, 13 Wis. 57; *Osgood v. Laytin*, 3 Keyes (N. Y.), 521.

⁴ Such was the form in *Hatch v. Dana*, 101 U. S. 205, and *Ogilvie v. Knox Ins. Co.*, 22 How. 380.

⁵ See *Crawford v. Rohrer*, 59 Md. 599.

⁶ 1 Woods, 463.

the objection was made that the proper parties were not before the court, Justice Bradley sustained the bill, saying in the course of his opinion: "A judgment creditor who has exhausted his legal remedy, may pursue in a court of equity any equitable interest, trust, or demand of his debtor, in whosoever hands it may be. And if the party thus reached has a remedy over against other parties for contribution or indemnity, it will be no defence to the primary suit against him that they are not parties. If a creditor were to be stayed until all such parties could be made to contribute their proportionate share of the liability, he might never get his money."¹

§ 706. So in *Hatch v. Dana*,² a creditor's bill brought against a portion of the shareholders, not to wind up the company, but simply to obtain the payment of the plaintiff's debt out of unpaid subscriptions, was sustained by the Supreme Court of the United States. "We hold that the complainant was under no obligation to make all the shareholders of the bank defendants in his bill. It was not his duty to marshal the assets of the bank, or to adjust the equities between the corporators. In all that he had no interest. The appellants may have had such an interest, and, if so, it was quite in their power to secure its protection. They might have moved for a receiver, or they might have filed a cross-bill, obtained a discovery of the other stockholders, brought them in, and enforced contribution from all who had not paid their stock subscriptions. Their equitable right of contribution is not yet lost."³

§ 707. Instead of himself suing, a creditor may apply for the appointment of a receiver, whose function it will be to collect unpaid subscriptions.⁴ And after the appointment of a receiver,

¹ *Marsh v. Burroughs*, 1 Woods, 253. Compare *Griffith v. Mangam*, 463, 468. See, also, *Bartlett v. Drew*, 73 N. Y. 611.
57 N. Y. 587.

⁴ See § 542.

² 101 U. S. 205.

³ *Hatch v. Dana*, 101 U. S. 205, 214; opinion of the court per Strong, J.; accord, *Ogilvie v. Knox Ins. Co.*, 22 How. 380; *Cornell & Michler's Appeal*, 114 Pa. St. 153; *Pierce v. Milwaukee Construction Co.*, 38 Wis. 509. A receiver should not call on shareholders for the balance of their unpaid subscriptions in order to pay creditors, until the whole amount of the corporate indebtedness is determined and the liability of each shareholder fixed. *Chandler v. Keith*, 42 Iowa, 99; *Mann*

a creditor cannot bring suit in his own name for unpaid subscriptions; nor prosecute a suit further if he has already begun one.¹ Unpaid subscriptions, moreover, being part of the assets of the corporation, pass by a decree in bankruptcy to its assignee; after which he and not the creditors should sue for them. And the mere fact that the assignee has delayed for two years in bringing suit does not enable creditors to sue.²

Appoint-
ment of
receiver.
Assignee in
bank-
ruptcy.

§ 708. Creditors may also restrain shareholders from withdrawing the corporate funds to the injury of the former, and can recover such funds from shareholders who have improperly received them.³ For instance, the shareholders of an insolvent bank are not entitled to receive or divide among themselves any of its assets until its debts and liabilities are fully discharged.⁴ And an action may be maintained by the receiver of an insolvent corporation against its shareholders to recover sums received by them as dividends when the corporation was insolvent.⁵ But where dividends have been properly paid from profits, the company being solvent at the time, its subsequently

Rights of
creditors
against
share-
holders im-
properly
withdrawing
corpo-
rate funds.

v. Pentz, 3 N. Y. 415. But see *Dayton v. Borst*, 31 N. Y. 435.

¹ *Rankine v. Elliot*, 16 N. Y. 377.

In a creditor's action against an insolvent corporation for the appointment of a receiver, a court has no jurisdiction to grant an interlocutory order making an assessment on the unpaid stock, as against shareholders not parties to the bill, the bill containing no allegation that they are too numerous to be made parties. *Lamar Ins. Co. v. Hildreth*, 55 Iowa, 248.

² *Lane v. Nickerson*, 99 Ill. 284.

But a bill brought by creditors, alleging collusion between the corporation, its assignee, and its debtors, may be sustained. *Stocks v. Van Leonard*, 8 Ga. 511.

³ *Bartlett v. Drew*, 57 N. Y. 587.

See § 656.

⁴ *Wood v. Dummer*, 3 Mason, 308; *Hollister v. Hollister Bank*, 2 Keyes (N. Y.), 245.

⁵ *Osgood v. Laytin*, 3 Keyes (N. Y.), 521; *Lexington Life, etc. Ins. Co. v. Page*, 17 B. Mon. (Ky.) 412. Especially if the dividends were paid out of capital. *Williams v. Boice*, 38 N. J. Eq. 364. Although a statute makes the directors personally liable for all dividends paid out of capital. *Ib.*; §§ 566, 567. Similarly a preferred shareholder is postponed to creditors. *St. John v. Erie Railway Co.*, 22 Wall. 136. In such an action the receiver may make the creditors parties to restrain them from bringing separate suits against the shareholders. *Osgood v. Laytin, supra*.

accruing insolvency will not enable creditors to recover such dividends from the shareholders who have received them.¹

§ 709. Since the unpaid subscriptions just as much as those which are actually paid in, are held to constitute the capital of the corporation,² shareholders to the extent of their unpaid subscriptions have in their possession funds to which creditors of the corporation may be entitled; and shareholders may therefore, to the extent of their unpaid subscriptions, be regarded as trustees for creditors.³ Accordingly, the statute of limitations does not run against the right of creditors to enforce the payment of unpaid subscriptions until the corporation has ceased to be a going concern,⁴ or until a valid call has been made by the directors or by a court of competent jurisdiction, or at least some authorized demand has been made on the subscriber.⁵

§ 710. Further, the body corporate derives its powers to act as such from the constitution of the corporation; a proposition which involves the further proposition that it must exercise its powers in accordance with the terms of such constitution. These powers, accordingly, cannot be exercised in disregard of interests which just as much as the interests of shareholders are protected by rights which are the manifestations of legal rules contained in the constitution. And, therefore, in so far as shareholders, constituting the body corporate, have power to control the funds in which creditors have legally protected interests, shareholders must be regarded as occupying towards them a position of trust; for the latter have ordinarily no voice in the corporate management. As Justice Miller said, giving the opinion of the Federal Supreme Court, in *Sawyer v. Hoag*.⁶ "But, after all, this artificial body is but the representative of its stockholders, and exists mainly for their benefit, and is governed

¹ *Reid v. Eatonton M'f'g Co.*, 40 Ga. 98. See *McLean v. Eastman*, 21 Hun, 312.

² See § 661.

³ See §§ 41-47.

⁴ *Allibone v. Hager*, 46 Pa. St. 48, 54; *Payne v. Bullard*, 23 Miss. 88; *Curry v. Woodward*, 53 Ala. 371, 376.

See *Harmon v. Page*, 62 Cal. 448; *First Nat. B'k. v. Green*, 64 Iowa, 445.

⁵ *Scoville v. Thayer*, 105 U. S. 143, 155; *Western R. Co. v. Avery*, 64 N. C. 491. See *Glenn v. Saxton*, 68 Cal. 353.

⁶ 17 Wall., 610, 623.

and controlled by them through the officers whom they elect; and the interest and power of legal control of each shareholder is in exact proportion to the amount of his stock. It is, therefore, but just that when the interest of the public, or of strangers dealing with the corporation, is to be affected by any transaction between the stockholders who own the corporation, and the corporation itself, such transaction should be subjected to a rigid scrutiny, and if found to be affected with anything unfair toward such third person, calculated to injure him, or designed intentionally and inequitably to screen the stockholder from loss at the expense of the general creditor, it should be disregarded or annulled so far as it may inequitably affect him."¹

§ 711. Thus, the Federal Supreme Court has held that a foreclosure sale, made after a railroad company, the mortgagor, had become insolvent, and expedited by an arrangement between the mortgagees and the shareholders, by which the former received a part of the debt due them and the latter the remainder of the proceeds, is fraudulent as against the general creditors of the company; and this, although the road was mortgaged far above its value, and did not on the sale in open market bring nearly enough to satisfy even the mortgage debts.²

§ 712. Statutes imposing individual liability³ fall under two heads: those which make the shareholders jointly and seve-

¹ Thus, an insolvent bank cannot convey its property to pay a debt due its sole shareholder. *Swepson v. Bank*, 9 Lea (Tenn.), 713. But it has been held that a shareholder may avail himself of his superior advantages to obtain security for debts due him, to the exclusion of other creditors of the corporation. The court said that shareholders and strangers who are creditors stood on very unequal terms; but it seemed to be an inequality allowed by the law and understood by persons contracting with the corporation. *Whitwell v. Warner*, 20 Vt. 425, 444. See *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439, 452.

² *Railroad Co. v. Howard*, 7 Wall. 392. But compare *Pennsylvania Transportation Co.'s Appeal*, 101 Pa. St. 576, where it was held that the bondholders and shareholders of a railroad company may unite for the purchase of the property of the company at a contemplated foreclosure sale, to prevent a sacrifice of the property; and if the agreement and sale are fair, they do not operate as a fraud on a creditor, who had notice of the sale and an opportunity of bidding.

³ Statutes imposing a further liability on shareholders towards creditors, do not impliedly deprive creditors of their right to enforce payment

rally liable for all the debts of the corporation, and those which add a further limited liability to the liability arising, according to the general rules of corporation law, from subscribing for stock. The extent of this limited liability may be made dependent on the number of shares held, or on the proportion which that number bears to the whole number of shares in the capital stock. Statutes imposing a limited liability may be subdivided into those in accordance with the tenor and import of which a single creditor may sue a single shareholder at law; and those which are construed to render the shareholders liable to contribute a proportionate amount to a common fund for the ratable benefit of all creditors. To enforce the liability of shareholders under the latter, all the creditors must join in a suit in equity, or one creditor must sue in equity on behalf of all other creditors; and in so far as is practicable, all the shareholders must be joined as defendants.

§ 713. It is ordinarily provided by all these statutes—those which impose a limited, as well as those which impose an unlimited liability—that a creditor shall obtain judgment against the corporation, and that execution shall be levied thereunder, and returned wholly or partially unsatisfied before he can proceed against a shareholder individually.¹

of subscriptions for stock. See *Bunn's Appeal*, 105 Pa. St. 49; *Warner v. Callender*, 20 O. St. 190.

¹ But these conditions precedent are not always imposed. Thus, when it was provided by a certain charter that the "members of the company shall be jointly and severally liable for all debts and contracts made by the company until the whole amount of the capital stock fixed and limited by the corporation" is paid in, it was held that the liability of shareholders was unconditional, original, and immediate, not dependent on the insufficiency of the corporate assets, and not collateral to that of the corporation, upon the event of its insolvency; and that upon a bill

filed against a corporation for a debt under seal, the shareholders were properly made parties, in order to avoid a multiplicity of suits. *Manufacturing Co. v. Bradley*, 105 U. S. 175. See also *Culver v. Third Nat. B'k*, 64 Ill. 528; *Bird v. Calvert*, 22 S. C. 292.

On the other hand, such conditions may be implied from the tenor of the statute. Thus, where shareholders in a bank were made liable jointly and severally to creditors for the deposits, it was held that their liability was secondary, and could not be enforced until the assets of the bank had been exhausted. *Mean's Appeal*, 85 Pa. St. 75. See also *Harper v. Union*

§ 714. The general nature of the personal statutory liability of shareholders for corporate indebtedness has been much discussed;¹ some courts having held such liability to be that of partners; while in Michigan it is said to be that of guarantors. The truth is, the liability of shareholders under statutes imposing individual liability for corporate indebtedness is *the liability of shareholders under such statutes*, and to speak of it as the liability of guarantors, or the liability of partners, is to call it what it is not.²

Nature of
statutory
liability.

§ 715. That it is not the liability of guarantors seems too evident to require argument. Suretyship is a legal institution composed of peculiar rules based on the general notion that a surety is a man conferring a benefit and receiving none in

M'f'g Co., 100 Ill. 225. Compare *Hatch v. Burroughs*, 1 Woods, 439; *Grindle v. Stone*, 78 Me. 176. See also § 724.

¹ The statutory liability of shareholders, whether limited or unlimited, which last is unusual, ordinarily arises *ex contractu*, and is not a penalty. See *Norris v. Wrenchschall*, 34 Md. 492; *Flash v. Conn*, 109 U. S. 371. Such liability cannot be repealed so as to affect the vested rights of creditors. *Hawthorne v. Calef*, 2 Wall. 10; *Provident S'v'gs Ins. v. Jackson Place Skating Rink*, 52 Mo. 552. Not even by a state constitutional amendment. *St. Louis R'y Supplies Co. v. Harbine*, 2 Mo. App. 134. See §§ 500, 501; also § 735. It survives the death of a shareholder, and attaches to his personal representatives. *Richmond v. Irons*, 121 U. S. 27; *Grew v. Breed*, 10 Met. (Mass.) 569.

Where this liability sounds in contract it will be enforced outside the limits of the state chartering the corporation; at least, if the necessary parties can be brought within the jurisdiction of the foreign court. *Hodgson v. Cheever*, 8 Mo. App.

318. Compare *Lowry v. Inman*, 46 N. Y. 119. See § 394.

Thus liability attaching to shareholders until the total capital stock is paid in, and a certificate to that effect filed will be enforced outside the state. *Cuykendall v. Miles*, 10 Fed. Rep. 342.

On the other hand, any liability of shareholders or officers contingent on the failure of the latter to publish or file reports is penal, and will not be enforced outside the state. *Wood v. Wicks*, 7 Lea (Tenn.), 40. Such penal liability will be strictly construed in favor of the shareholders. *Cady v. Smith*, 12 Neb. 628, 630. Compare *Smith v. Steele*, 8 Neb. 115. And it has been held not to survive the death of the person affected with it. *Diversey v. Smith*, 103 Ill. 378.

² The nature of this liability in any particular case depends, of course, on the intent of the statute creating it. Under some statutes it will resemble the liability of guarantors, and under others that of partners. But neither the rules of suretyship nor the rules of partnership law will ever be wholly and exclusively applicable.

return, whose contract, therefore, is to be construed strictly in his own favor.¹ It is evident that the situation of a shareholder is very different,² and the decision in the Michigan case,³ that the shareholder was a guarantor who was discharged because time was given the corporation, is against the weight of authority, and apparently a mistaken decision.⁴

§ 716. The temptation to speak of the statutory liability of a shareholder as the liability of a partner is more insidious, because of the resemblance between the two kinds of liability. But it is evident that the status of a shareholder in a corporation to members of which personal liability attaches, differs much from that of a partner.⁵ Shareholders are not, like partners, each other's agents; unlike partners, they may transfer their shares at will; then ordinarily, even in respect of his statutory liability, a shareholder cannot be sued until the creditor has exhausted his legal remedies against the corporation; and finally, under some statutes, a shareholder may be sued alone, though in the end he is entitled to contribution from his fellow shareholders. Undoubtedly there remains the main resemblance

¹ See *Ward v. Stahl*, 81 N. Y. 406.

² See *Emerson v. Slater*, 22 How. 28.

³ *Hanson v. Donkerly*, 37 Mich. 184. One dissenting opinion was read. Compare *National Loan Ass'n v. Lichtenwalner*, 100 Pa. St. 100; *Milroy v. Spur Mountain Iron Mining Co.*, 43 Mich. 231.

⁴ Directly contra to *Hanson v. Donkerly* are *Harger v. McCullough*, 2 Denio (N. Y.), 119; *Moss v. Averell*, 10 N. Y. 449; *Aultman's Appeal*, 98 Pa. St. 505; *Young v. Rosenbaum*, 39 Cal. 646; *Sonoma Valley Bank v. Hill*, 59 Cal. 107; *Hatch v. Burroughs*, 1 Woods, 439. The view taken in *Hanson v. Donkerly* seems overruled in *Grand Rapids Savings B'k v. Warren*, 52 Mich. 557.

To be sure, where, under the statute, suit must be commenced against a shareholder within one year after the

debt of the corporation became due, the liability of the shareholder cannot be extended by any extension or renewal of the indebtedness of the corporation, as by taking its note. *Parrott v. Colby*, 6 Hun, 55; S. C., aff'd, 71 N. Y. 597; *Jagger Iron Co. v. Walker*, 76 N. Y. 521. Compare *Dryden v. Kellogg*, 2 Mo. App. 87. But this is very different from an extension to the corporation discharging the shareholder before the expiration of the period limited by the statute for the commencement of suit against him.

⁵ Corporators are not partners, even though rendered liable by statute for certain debts of the corporation. *Baker v. Backus*, 32 Ill. 79. Compare *United States v. Knox*, 102 U. S. 422, to see how unlike the liability of partners is the statutory liability of shareholders, § 727.

between the liability of partners and the statutory liability of shareholders, that a shareholder as well as a partner is liable individually for the debts of the corporation or firm, a resemblance which is especially prominent in the unlimited liability¹ of a shareholder who like a partner may be obliged to pay all the debts of the concern. And the danger lies here, lest with eyes fixed on this main resemblance courts overlook minute differences, and in consequence fail to do accurate justice. The perception of a resemblance is often nothing but a failure to see differences. Corporations are largely regulated by statute, and differ in so many respects from partnerships that errors must be introduced by an indiscriminate reasoning from the analogy of the latter institutions.²

“In order to contrast the nature of the liability of shareholders with that of partners, companies must be divided into those which are incorporated and those which are not, and each class must be again subdivided, for, owing to the diversity of the statutes relating to companies, little is common to them all. The general principles which require to be borne in mind, are, first, that unincorporated companies are not at common law distinguishable from partnerships; and, secondly, that incorporated companies are distinguishable from them, and that the shareholders in such companies are not liable for the corporate debts and engagements save so far as they are rendered so by act of Parliament. If shares in an incorporated company are registered in the names of two persons and one of them dies, the survivor is the only person liable to be made a contributory in respect of them.”³

§ 717. This doctrine that shareholders in corporations are not liable for the corporate debts, save so far as they are rendered so by the statute imposing the individual liability, does not accord with the view taken in *Corning v. McCullough*,⁴ where it was said that by these statutes shareholders are not made but *left* liable for the

Shareholders not
left, but
made liable.

¹ Unusual in this country.

² See §§ 67-69. Shareholders made “individually responsible for an amount equal to the amount of stock held by them respectively” were said to be

partners in *Thompson v. Meisser*, 108 Ill. 359.

³ 1 Lindley on Partnerships, 375, citing *Hill's Case*, L. R. 20 Eq. 595.

⁴ 1 N. Y. 47.

corporate indebtedness. The difference is important. If the shareholder is left liable, in every case of doubt there is a presumption in favor of his liability; while if he is made liable, his liability is to be deduced from a fair construction of the statute. The view of Baron Lindley seems the correct one, and accords with the prevailing doctrine in America. "Individual liability is repugnant to the law of corporations, and qualifies in this case an exemption which would otherwise exist. Stockholders in such cases are liable according to the plain meaning of the terms employed by the legislature, and not otherwise."¹

Moreover, it would seem that if shareholders are *left* liable, and the statute "leaving" them so prescribe at the same time a way of enforcing their liability, the course prescribed by the statute may be disregarded, and the shareholder may be proceeded against in some other manner. And this is not law.²

§ 718. A question sometimes very difficult to answer in regard to this statutory liability is: What shareholders are subject to it? Those who were such when the corporation incurred the indebtedness, or those who are such when suit is brought against them, or the corporation is dissolved or wound up?

To what shareholders' statutory liability attaches.

Many cases have held that the shareholder who was such at the time when the corporation contracted the debt is the one liable.³

In the absence of any indication in the statute, the question seems to be whether the analogy of partnership or corporation

¹ Carroll v. Green, 92 U. S. 509, 512, opinion of the court per Swayne, J. See also Terry v. Little, 101 U. S. 216; Chase v. Lord, 77 N. Y. 1.

² Statutory liability can be enforced only in the mode prescribed by the statute. Hoard v. Wilcox, 47 Pa. St. 51; Youghiogeny Shaft Co. v. Evans, 72 Pa. St. 331; Dauchy v. Brown, 24 Vt. 197; Peck v. Coalfield Coal Co., 3 Ill. App. 619. Provided, of course, the statute express the remedy. See same cases.

³ Moss v. Oakley, 2 Hill (N. Y.). 265; Judson v. Rossie Galena Co., 9 Paige, 598; Young v. New York, etc. Steamship Co., 15 Abb. Pr. (N. Y.) 69; Tracy v. Yeates, 18 Barb. 152; Williams v. Hanna, 40 Ind. 535; Wehrman v. Reakirt, 1 Cincinnati Supr. Ct. 230; Larrabee v. Baldwin, 35 Cal. 155; Windham Provident Ins. Co. v. Sprague, 43 Vt. 502; Chesley v. Pierce, 32 N. H. 388; Brown v. Hitchcock, 36 Ohio St. 667; see McKelumne Hill Canal Co. v. Woodbury, 14 Cal. 265; Davidson v. Rankin, 34 Cal. 503. Compare McCullough v. Moss, 5 Denio (N. Y.), 567.

law is to be followed. The transferability of shares is a universal element of corporation law; just as much is it the universal doctrine of partnership law that the interest of a partner is not transferable. According to partnership law, it is the partner who was such at the time when the debt was contracted who is liable; in accordance with the doctrine of the transferability of shares by which a transfer constitutes a complete novation—a doctrine of which every creditor of the corporation had notice—it would seem equally clear that the transferee or shareholder who holds the shares when suit is brought to enforce the individual liability, or who holds them at the winding up of the corporation, is the person liable.¹ And, moreover, the chief argument in favor of holding liable the shareholders who are such when the debt is contracted, *i. e.*, that persons contracting with the corporation rely on the credit of the then shareholders, loses its force in view of the prevailing American rule, according to which a transfer made to an irresponsible person when the corporation is in failing circumstances is void as to creditors; a rule which applies as fully in regard to the statutory liability of shareholders as in regard to their liability for unpaid subscriptions.²

§ 719. Let us test the analogy of partnership law in this respect. “As the firm is not liable for what is done by its members before the partnership between them commences, so upon the very same principle a person who is admitted as a partner into an existing firm does not by his entry become liable to the creditors of the firm for anything done before he became a partner. Each partner is, it is true, the agent of the firm, but . . . the firm is not distinguishable from the persons from time to time composing it; and when a new member is admitted he becomes one of the firm for the future, but not as from the past, and his present connection with the firm is no evidence that he ever expressly or impliedly authorized what may have been done prior to his admission. It may, perhaps,

¹ See § 720.

Mason v. Alexander, 44 O. St. 318,

² See dissenting opinion in Brown v. Hitchcock, 86 Ohio St. 667. See § 749. As to Brown v. Hitchcock, *supra*, the same court followed it in saying that they were not prepared to assume the responsibility of overruling it.

be said that his entry amounts to a ratification by him of what his now partners may have done before he joined them. But it must be borne in mind that no person can be rendered liable for the act of another on the ground that he has ratified, confirmed, or adopted it, unless at the time the act was done, it was done on his behalf."¹

These concise remarks of Baron Lindley are certainly true as to partnerships; but their inapplicability to corporations shows the lameness of the analogy between corporations and partnerships. As the learned Baron says: "A person who is admitted as a partner into an existing firm, does not by his entry become liable to the creditors of the firm for anything done before he became a partner." But by purchasing partially paid-up shares, the buyer, to the extent of the unpaid subscriptions due on them, renders himself liable for the debts of the corporation, whether contracted before or after he became a shareholder.² Further on in the same extract, Baron Lindley says in substance, that the entry of a new partner into a firm cannot by any implied ratification make him liable for the previously contracted indebtedness of the firm, because, in contracting such indebtedness, the firm did not act in his behalf. But, on the other hand, acts of a corporation are always done on behalf of persons occupying in respect of that corporate enterprise the status of shareholder, either at the time the acts were done, or subsequently. This is implied by the principle of "perpetual succession," fundamental in corporation law.³ Accordingly, the general rule that transferees of shares succeed to the rights and liabilities of their transferors, is established beyond controversy.⁴

¹ 1 Lindley on Part., 389.

² Webster v. Upton, 91 U. S. 65; Moses v. Ocoll Bank, 1 Lea (Tenn.), 398.

³ See §§ 15, 17.

⁴ Hartford and N. H. R. R. Co. v. Boorman, 12 Conn. 530; Mann v. Currie, 2 Barb. 294; Webster v. Upton, 91 U. S. 65; Moses v. Ocoll Bank, 1 Lea (Tenn.), 398. See § 587.

"When a person takes shares in a company, he, as between himself and other shareholders, takes these shares with all the rights and liabilities attaching to them, so that his co-shareholders have a perfect right to insist upon his contributing with them towards the liquidation of debts contracted before he joined the company. And even as to creditors, the liability of shareholders to them does not de-

§ 720. Thus, as there is reason to hold that the purchaser of shares assumes all the liability connected with them, the reasons for holding that the seller continues liable seem to fail; as presumably the legislative intention was not to make two sets of shareholders liable for the same indebtedness on the same shares. The creditors in contracting may have relied on the individual responsibility of the then shareholders, but none the less were they affected with notice of the transferability of shares.

In view of the preceding discussion, and the impropriety of introducing anomalies into corporation law, it would seem correct, in the absence of provision or indication in the statute

pend altogether upon the principles of partnership, but upon statutory enactments." 1 Lindley on Part., 394, citing *Taylor v. Ifill*, 1 N. R. 566, V. C. W.; *Cape's Executors' Case*, 2 De G. M. & G. 562; *Mahew's Case*, 5 De G. M. & G. 837. "It may be stated generally that in all companies regulated by the Companies Act of 1862, an incoming shareholder is, so long as he remains a shareholder, liable to creditors in respect of debts incurred by the company before he became a shareholder." 1 Lindley on Part., 395. Compare *Blundell v. Winsor*, 8 Sim. 601, 613.

Under certain statutes, however, *e. g.* (N. Y. M'f'g Cos. Act of 1848), shareholders are held not liable to creditors for the debts of the company contracted before they became shareholders. *Tracy v. Yeates*, 18 Barb. 152; *Phillips v. Therasson*, 11 Hun, 141; *Weber v. Fickey*, 47 Md. 196; contra, *Curtis v. Harlow*, 12 Metc. 3. Compare *Longley v. Little*, 26 Me. 162. Nevertheless, a transferee may be liable to indemnify his transferrer in respect of a debt for which, to creditors, the transferee is not, under the statute, held liable; and on that ac-

count, if the transferee is solvent and within the jurisdiction of the court, a creditor suing the transferrer should make the transferee a party. *Wheeler v. Faurot*, 37 Ohio St. 26. See *Brown v. Hitchcock*, 36 Ohio St. 667.

In Massachusetts, under a statute, whereby shareholders are made jointly and severally liable for all debts and contracts made by the corporation until the whole amount of the capital stock is paid in, a shareholder is liable for debts contracted while he remains such, although his membership cease before the debts become payable. But he is not liable for debts contracted before he became a shareholder if his membership expires before the debts are payable or suit is brought against him. *Holyoke Bank v. Burnham*, 11 Cush. 183. See *Johnson v. Somerville Dyeing, etc. Co.*, 15 Gray, 216. Compare *Curtis v. Harlow*, 12 Metc. 3. The liabilities to which a transferee of shares succeeds are those incidental to the relationship of shareholder; they do not include the liability to return dividends improperly received by the transferrer. *Hurlbut v. Taylor*, 62 Wis. 607.

to the contrary,¹ to hold that all liability in respect of shares ceases upon the absolute² and regular transfer of them to a person capable of succeeding to the liabilities of the former holder; provided the transfer be not made to an irresponsible person in fraud of creditors.³

§ 721. In respect of enforcing the statutory liability of shareholders to creditors, it may be said generally that the suit must be brought by the creditors and not by the corporation or its receiver.⁴ This liability, whether limited or not, is a security provided by law for the benefit of the creditors, over which the corporation has no control; and, consequently, an attempted assignment by the corporation of the statutory liability of shareholders is inoperative, although made for the equal benefit of all the creditors.⁵

§ 722. As to the necessary allegations in the complaint, it is impossible to state any more definite rule than simply that the

¹ See *Hebby's, etc. Case*, L. R. 2 Eq. 167.

² See *Veiller v. Brown*, 18 Hun, 571; § 747.

³ See §§ 747-749. The following decisions support the result reached in the text: *McLaren v. Franciscus*, 43 Mo. 452; *Shrainka v. Allen*, 76 Mo. 384; *Bond v. Appleton*, 8 Mass. 472; *Curtis v. Harlow*, 12 Metc. 3; *Child v. Coffin*, 17 Mass. 64; *Middleton Bank v. Magill*, 5 Conn. 28 (a case of unlimited liability); *Cleveland v. Burnham*, 55 Wis. 598; *Nixon v. Green*, 11 Exch. 550. See *Marcy v. Clark*, 17 Mass. 330; 335; *Cape's Executors' Case*, 2 De G. M. & G. 562; *Grise-wood & Smith's Case*, 4 De G. & J. 544; *Griswold v. Seligman*, 72 Mo. 110, 119. See *Root v. Sinnock*, 120 Ill. 350.

The authorities are so conflicting, and the statutes so diverse, that the only safe rule for a practitioner is to seek for decisions under the statute affecting his client, or statutes pre-

cisely similar in terms. It would be well for the legislature always to designate the class of shareholders intended to be made liable. See, *e. g.*, N. Y. Rev. Stat., 7th ed., p. 1721, § 10.

⁴ *Farnsworth v. Dewey*, 91 N. Y. 308; *Lane v. Morris*, 8 Ga. 468, 476; *Bristol v. Sanford*, 12 Blatchf. 341; *Jacobson v. Allen*, 20 Blatchf. 525; S. C., 12 Fed. Rep. 454; *Wincock v. Turpin*, 96 Ill. 135; *Liberty Female College Ass'n v. Watkins*, 70 Mo. 13. Compare the two cases of *Harris v. First Parish*, 23 Pick. 112, and *Baker v. Atlas Bank*, 9 Metc. 182.

A judgment creditor of the corporation may, in the same action, join a claim to compel the payment of stock subscriptions and a claim to enforce the individual statutory liability. *Warner v. Callender*, 20 Ohio St. 190.

⁵ *Wright v. McCormack*, 17 Ohio St. 86; *Umsted v. Buskirk*, ib. 113; *Dutcher v. Maine Nat. B'k*, 12 Blatchf. 435.

complaint must contain the allegations essential to make out a case under the particular statute relied on. Thus, where the charter declares that "in all cases of losses exceeding the means of the corporation, each stockholder shall be held liable to the amount of unpaid stock held by him," the complaint must aver that the losses or liabilities of the company exceed its assets.¹ But it may not always be necessary for the creditor to aver that the corporation is insolvent, or that the creditor has obtained a judgment against it, unless the statute makes the liability of the shareholder contingent on such insolvency, or requires the creditor to exhaust his remedies against the corporation before suing a shareholder.²

Necessary
averments
in plead-
ings.

§ 723. In New York, under the Manufacturing Companies Act of 1848, the stockholders are made "severally individually liable to the creditors of the company, . . . to an amount equal to the amount of stock held by them respectively, for all debts and contracts made by such company until the whole amount of capital stock fixed and limited by such company shall have been paid in, and a certificate thereof filed and recorded as prescribed. . . ." ³ Under this act, as amended

¹ *Blair v. Gray*, 104 U. S. 769.

² *Manufacturing Co. v. Bradley*, 105 U. S. 175; *Perkins v. Church*, 31 Barb. 84; *Hodges v. Silver Hill M'g Co.*, 9 Oregon, 200; *Morrow v. Superior Court*, 64 Cal. 383. See *Culver v. Third Nat. Bank*, 64 Ill. 528; *Spence v. Shepard*, 57 Ala. 598.

Taking a pledge of corporate property has been held not to prevent the creditor from suing the shareholders without selling the pledge. *Sonoma Valley Bank v. Hill*, 59 Cal. 107.

³ If the certificate is filed in the county clerk's office as required, the failure of the clerk to record it will not render the shareholders liable. *Sutherland v. Olcott*, 29 Hun, 161. Reversed on other grounds, 95 N. Y. 93; acc.

on this point, *Veeder v. Mudgett*, 95 N. Y. 295.

A stockholder is not relieved from this liability by having paid in full for his own shares. *Wheeler v. Millar*, 90 N. Y. 353; acc. *Tibbals v. Libby*, 87 Ill. 142. Compare *Schricker v. Ridings*, 65 Mo. 208, and *Lewis v. St. Charles County*, 5 Mo. App. 225. Under the New York Manufacturing Companies Act of 1848 to end the liability of shareholders, the capital stock must have been paid in, as well as a certificate to that effect filed. The statement in the certificate is not conclusive of the fact of payment, in favor of shareholders.

Although where the corporation has no power to increase its capital stock,

by Chapter 333 of the Laws of 1853, by which shares may be paid for in property, in order to charge the holder of stock issued for property individually with the debts of the corporation, it is not enough to prove that the property was purchased at an over-valuation through a mere mistake or error of judgment on the part of the company's trustees. The purchase must be shown to have been made in bad faith, with intent to evade the statute. But in such case in order to establish legal fraud it is only necessary to prove, (1) that the stock exceeded in amount the value of the property in exchange for which it was issued, and (2) that the trustees issued it deliberately, and with knowledge of the real value of the property overvalued the same.¹ It may properly be left with the jury to say whether "the property was placed and taken at a higher valuation with a fraudulent purpose, with the intent to evade the statute."²

stock issued in excess of the limit is void, and the holders of it are not liable to creditors thereon, yet where the power to increase the stock exists, and there is a way in which the increase may lawfully be made, the creditors are entitled to rely on the assumption that the increase has been lawfully effected, and the holders of the stock will be estopped from setting up its illegal or irregular issue (see § 541), when they have voted for the increase, accepted the stock, and received dividends thereon.

The new shares of the stock so increased become subject to the liability of this section until fully paid up and a certificate filed; but the fact of their remaining unpaid does not revive the liability of the holders of the original shares, which are paid up, and a certificate filed as required.

The provision that the certificate shall be made *within thirty days* is but directory. *Veeder v. Mudgett*, 95 N. Y. 295.

Interest will be allowed on the creditor's claim from the time when he begins his action against the stockholder, even though such allowance of interest increase the claim to a sum exceeding the amount of stock held by the defendant. *Burr v. Wilcox*, 22 N. Y. 551; *Handy v. Draper*, 89 N. Y. 334; *Shellington v. Howland*, 53 N. Y. 371. Contra, *Cole v. Butler*, 43 Me. 401, 405; *Sackett's Harbor Bank v. Blake*, 3 Rich. Eq. (S. C.), 225, 233. And where the entire principal and interest of the debt do not exceed the amount of the stockholder's liability as limited by the statute, interest will be allowed as against the stockholder from the maturity of the debt. *Wheeler v. Millar*, 90 N. Y. 353.

¹ *Douglass v. Ireland*, 73 N. Y. 100. See also *Schenck v. Andrews*, 57 N. Y. 133; *Boynton v. Andrews*, 63 N. Y. 93; *Boynton v. Hatch*, 47 N. Y. 225.

² *Lake Superior Iron Co. v. Drexel*, 90 N. Y. 87.

§ 724. Where the statute prescribes conditions precedent which are to be performed by a creditor to entitle him to sue a shareholder, the latter may plead im-
 proper or non-performance of them.¹ Thus, under the New York Manufacturing Companies Act of 1848, before referred to, it is a condition precedent to the maintaining of an action by creditors against stockholders that the former should have obtained a judgment against the corporation, and that an execution should have been issued thereunder and returned wholly or partially unsatisfied.² A proceeding *in rem*, affecting only the corporate property attached, is not a compliance with this condition.³ If, however, the conditions precedent to a liability of a stockholder under this statute are rendered impossible by the paramount law of the United States, set in operation by the stockholder himself, performance of them by creditors is excused.⁴

Perform-
 ance by
 creditors of
 conditions
 precedent.

§ 725. It is a difficult matter to state rules of general applicability regarding the joinder of parties in actions to enforce the statutory liability of shareholders. For there is great diversity in the language of the different statutes; and the decisions are hard to reconcile.

Joinder of
 parties.

When shareholders are made severally individually liable to

¹ See *Fourth National Bank v. Franklin*, 120 U. S. 747. Due diligence seems to be required of the creditor to discover property of the corporation before a *scire facias* will be issued against a shareholder. *Hitchens v. Kilkenny, etc. R. R. Co.*, 15 C. B. 459. Still, where the statute provides that execution against the corporation must first have been returned unsatisfied, no greater diligence is required than is implied in obtaining judgment, suing out an execution, and getting a return of *nulla bona* thereunder. *Thornton v. Lane*, 11 Ga. 459, 514; *Bank of United States v. Dallam*, 4 Dana (Ky.), 574. But notice should be given the shareholder, that he may point out corporate

property. *Lane v. Harris*, 16 Ga. 217, 224. See also *Lane v. Morris*, 8 Ga. 468; *Paine v. Stewart*, 33 Conn. 516, 531; *Toucey v. Bowen*, 1 Biss. 81; *Grew v. Breed*, 10 Mete. 569, 579. See § 713.

² *Handy v. Draper*, 89 N. Y. 334, reversing S. C., 23 Hun, 256. See *Kincaid v. Dwinelle*, 59 N. Y. 548; *Dean v. Mace*, 19 Hun, 391.

³ *Rocky Mountains National Bank v. Bliss*, 89 N. Y. 338.

⁴ *Shellington v. Howland*, 53 N. Y. 371; followed in *Flash v. Conn*, 109 U. S. 371. The National Bankruptcy Act is referred to. Compare *Ansonia B. & C. Co. v. New Lamp Chimney Co.*, 53 N. Y. 123.

the creditors of the corporation to an amount equal to the amount of stock held by the shareholders respectively, a single creditor may sue one or more shareholders as he deems proper in an action at law.¹ Where, however, the shareholders are simply made individually liable for the corporate indebtedness, to an amount equal either to the par value of the shares held by them respectively or in the proportion which their shares bear to the total amount of the capital stock, the rule applied in many cases is that all the shareholders, so far as practicable, should be joined in an action in equity; which should be brought by all the creditors, or in such a form that all the creditors may come in.² "The creditors should all join because they have a common interest in the funds to be realized;

¹ *Flash v. Conn*, 109 U. S. 371; 409; *Simonson v. Spencer*, 15 Wend. Garrison v. Howe, 17 N. Y. 458; 548.

Mathez v. Neidig, 72 N. Y. 100; ² *Coleman v. White*, 14 Wis. 700; *Weeks v. Love*, 50 N. Y. 568; *Mann Overmyer v. Cannon*, 82 Ind. 457; *v. Pentz*, 3 N. Y. 415; *Bank of Von Glahn v. Harris*, 73 N. C. 323; *Poughkeepsie v. Ibbotson*, 24 Wend. Johnson v. Fisher, 30 Minn. 173; 473; *Wincock v. Turpin*, 96 Ill. 135; *Terry v. Martin*, 10 S. C. 263; *Eames v. Doris*, 102 Ill. 350; *Tunesma v. Schuttler*, 114 Ill. 156. See *Smith v. Huckabee*, 53 Ala. 191; *Jones v. Jarman*, 34 Ark. 323; and cases in following notes. Compare *Hull v. Burtis*, 90 Ill. 213. *Semble contra*, *Morrow v. Supreme Court*, 64 Cal. 383.

Where stockholders are made liable jointly and severally liable to the creditors in an amount," etc., a single creditor can sue a single shareholder at law. *Hall & Co. v. Klinck*, 25 S. C. 348. But see *Harper v. Union M'fg Co.*, 100 Ill. 225. These cases hold that an action at law is open to the creditor although he might have sued in equity. But under a Pennsylvania statute an action at law has been held the exclusive remedy. *Brinham v. Wellersburg Coal Co.*, 47 Pa. St. 43. See *Deming v. Bull*, 10 Conn.

Where stockholders are made liable to pay up their shares and also to an amount equal to the amount of their stock, a creditor may, on behalf of himself and other creditors, bring a suit in equity against the stockholders, the assignee in bankruptcy of the corporation and such creditors as have brought suits at law, to collect the sums due from the stockholders, distribute the same, and restrain the prosecution of the other suits. *Pfohl v. Simpson*, 74 N. Y. 137.

or, if the action is commenced by one or more of them, the complaint should be so framed that the others may come in and prove their claims before the court or a referee, and share in the distribution of the moneys received. All the stockholders should be made defendants, because they too have a common interest, and without their presence it is impossible to adjust their rights and liabilities, and protect them from unequal and oppressive burdens. The same reasons exist for making all the stockholders parties to such actions as in proceedings against delinquent stock subscribers to compel them to contribute towards the payment of the debts of an insolvent bankrupt corporation. The corporation should be joined, unless it has been dissolved or its assets wholly exhausted, for the reason that both creditors and stockholders are interested in closing its affairs, and in having its available property appropriated to the payment of debts, without which there can be no final settlement and adjudication of the rights and liabilities of the parties."¹

§ 726. The underlying distinction seems to be as follows: If the shareholders are made severally and individually liable to the creditors directly, one creditor alone may sue a single shareholder, and at law. If, however, from the general tenor of the statute it may be inferred that the legislative intention was to create a fund which, on the inability of the corporation to pay its debts, should be collected and ratably distributed among its creditors, then the liability of each shareholder is rather to contribute to a common fund in a certain proportion than to pay the debt of any one creditor. In such case one shareholder cannot sue alone; all the shareholders, so far as practicable, should be made defendants; and equity is the proper tribunal.²

Giving the opinion of the Federal Supreme Court in *Terry v. Little*,³ Chief Justice Waite said: "The individual liability of stockholders in a corporation is always a creature of statute.

¹ *Coleman v. White*, 14 Wis. 700, Palmer, 117 Ill. 619; *Crease v. Babcock*, 10 Metc. (Mass.) 525; *Grew v.*

² *Pollard v. Bailey*, 20 Wall. 520; *Breed*, ib. 569. Compare *Mills v. Terry v. Little*, 101 U. S. 216; *Eames* Scott, 99 U. S. 25.
v. Doris, 102 Ill. 350; *Queenan v.* ³ 101 U. S. 216, 217.

It does not exist at common law. The first thing to be determined in all such cases is, therefore, what liability has been created. There will always be difficulty in attempting to reconcile cases of this class in which the general question of remedy has arisen, unless special attention is given to the precise language of the statute under consideration. The remedy must always be such as is appropriate to the liability to be enforced. The statute which creates the liability may declare the purpose of its creation and provide directly or indirectly a remedy for its enforcement. If the object is to provide a fund out of which all creditors are to be paid, share and share alike, it needs no argument to show that one creditor should not be permitted to appropriate to himself, without regard to the rights of others, that which is to make up the fund.

“The language of the charter is peculiar. The stockholders are not made directly liable to the creditors. They are not in terms obliged to pay the debts, but are ‘liable and held bound . . . for any sum not exceeding twice the amount of . . . their . . . shares.’ This we think means that on the failure of the bank, each stockholder should pay such sum, not exceeding twice the amount of his shares, as shall be his just proportion of any fund that may be required to discharge the outstanding obligations. The provision is, in legal effect, for a proportionate liability by all stockholders. Undoubtedly the object was to furnish additional security to creditors, and to have the payments when made applied to the liquidation of debts. So, too, it is clear that the obligation is one that may be enforced by the creditors; but as it is to or for all creditors, it must be enforced by or for all. The form of the action, therefore, should be one adapted to the protection of all. A suit at law by one creditor to recover for himself alone is entirely inconsistent with any idea of distribution. As the liability of a stockholder is not to any individual creditor, but for contribution to a fund, out of which all creditors are to be paid alike, the appropriate remedy is by suit to enforce the contribution, and not by one creditor alone to appropriate to his own use that which belongs to others equally with himself.”

§ 727. The Federal Supreme Court has also rendered an instructive decision regarding the liability of shareholders in

national banks. The shareholders in a national bank are "individually responsible equally and ratably, and not one for another, for all contracts, debts, and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof, in addition to the amount invested in the shares."¹ An assessment of seventy per cent. of the value of their shares was made on the shareholders of an insolvent national bank, in order to discharge its liabilities. This assessment was not sufficient, but would have been if all the shareholders had been solvent and within the jurisdiction of the court. A creditor requested the comptroller of the currency to order a further assessment of thirty per cent., and to direct the receiver to proceed as before to collect it. The comptroller refused, and was sustained in his refusal by the Supreme Court, who held that this liability of shareholders was several and not joint, and that the insolvency of one shareholder, or his being beyond the jurisdiction of the court, did not affect the liability of another; and if the bank itself held any of its stock, the several liability of the other shareholders would not thereby be increased, but would be computed as if the stock held by the bank was in the hands of a natural person.² Giving the opinion of the court, Justice Swayne said: "In the process to be pursued to fix the amount of the separate liability of each of the shareholders, it is necessary to ascertain (1) the whole amount of the par value of all the stock held by all the shareholders; (2) the amount of the deficit to be paid after exhausting all the assets of the bank; (3) then to apply the rule that each shareholder shall contribute such sum

Liability of shareholders in national banks.

¹ Shareholders in national banks, liable for its debts, are liable for interest thereon (to the same extent with the bank), but not in excess of their maximum liability fixed by the statute. *Richmond v. Irons*, 121 U. S. 27.

² *United States v. Knox*, 102 U. S. 422. See also *Crease v. Babcock*, 10 Metc. 525; *Matter of the Hollister Bank*, 27 N. Y. 393. The Ohio Revised Statutes, § 3260, provide for joint action and ascertaining the proportion

each shareholder shall pay, up to the amount of stock held by him. In an action by a creditor to enforce the individual liability of shareholders under this statute, where not all the shareholders are before the court, and it does not appear that those not served could not have been served, it is error to assess on the shareholders served the whole amount of the corporate indebtedness. *Bonewitz v. Van Wert County Bank*, 41 O. St. 78.

as will bear the same proportion to the whole amount of the deficit as his stock bears to the whole amount of the capital stock of the bank at its par value."¹

§ 728. Under statutes by which shareholders are made liable to a certain limited amount, determined either by the number of shares held by them respectively, or by the proportion borne by that number to the total capital stock, a shareholder may extinguish his liability by paying a debt of the corporation equal in amount to the sum for which he is liable.²

¹ *United States v. Knox*, 102 U. S. 425. After such an assessment on the shareholders of a national bank has been made, a suit at law may properly be brought by the receiver to collect it. *Bailey v. Sawyer*, 4 Dill. 463.

§ 50 of the National Banking Act of 1864, which provides that suits to which officers or agents of the United States are parties shall be conducted by the district attorney, is so far but directory that it cannot be set up by shareholders to defeat a suit brought against them by a receiver, who, with the approval of the Treasury Department, had employed private counsel. In such a suit it is necessary that action on the part of the comptroller of the currency touching the personal liability of the shareholders, should precede the institution of any suit by the receiver, and the fact must be averred in the bill. It is no objection to such a bill that shareholders without the jurisdiction of the court are not made parties; and creditors are not proper parties to it. *Kennedy v. Gibson*, 8 Wall. 498, followed in *Casey v. Galli*, 94 U. S. 673. The liability of shareholders in national banks survives the death of a shareholder, and attaches to his representatives. *Richmond v. Irons*, 121 U. S. 27. But it

does not arise in respect to debts contracted after the bank has gone into liquidation. *Ib.*

² *Garrison v. Howe*, 17 N. Y. 458; *Woodruff, etc. Iron Works v. Chittenden*, 4 Bos. (N. Y.) 406; *Jones v. Wiltberger*, 42 Ga. 575; *Boyd v. Hall*, 56 Ga. 563; *San José Savings Bank v. Pharis*, 58 Cal. 380; *Thompson v. Meisser*, 108 Ill. 359.

When shareholders are liable to the amount of their stock, and a shareholder pays a corporate debt equal to the amount of his shares, he cannot be held liable again as to those shares, nor can the assignee of them be held liable. *Trebus v. Smiley*, 110 Ill. 316.

After a creditor, however, has begun a suit against a shareholder, then the latter cannot defeat him by paying another debt of the corporation. *Jones v. Wiltberger, supra.*

A shareholder cannot, under a double liability clause, get a friend to buy up claims at a discount, confess judgment in his favor, and then plead this judgment as a bar to other creditors of the corporation. *Manville v. Karst*, 16 Fed. Rep. 173. See *Buchanan v. Meister*, 105 Ill. 638. And when a shareholder is liable to creditors to an amount equal to the stock held by him, he cannot buy up claims

§ 729. A shareholder, however, indebted to an insolvent corporation for unpaid subscriptions, cannot, against his liability therefor, set off a debt owing him from the corporation. He is first bound as a shareholder to pay whatever may be due on his shares, whereupon he will be entitled to participate in the assets of the corporation ratably with the other creditors.¹ "The debts must be mutual; must be in the same right. . . . The debt which appellant owed for his stock was a trust fund devoted to the payment of all the creditors of the company. As soon as the company became insolvent, and this fact became known to the appellant, the right of set-off for an ordinary debt to its full amount ceased. It became a fund belonging equally in equity to all the creditors, and could not be appropriated by the debtor to the exclusive payment of his own claim."²

Set-off.
Unpaid
subscriptions.

§ 730. Likewise, a shareholder, who has been paid dividends by an insurance company when insolvent, cannot, in a suit by its receiver to recover them, set off his claims as a creditor of the corporation.³ "The defendant must restore the trust funds received in violation of law and improperly withheld, and then he will be in a position to claim, as a creditor of the company, a participation in common with other creditors, in a fund realized and secured for their common benefit; but, I apprehend, not till then."⁴

Set-off.
Dividends
improperly
received.

§ 731. On similar principles, if the statutory liability of shareholders is in effect to contribute to a common fund to be ratably distributed among creditors, or if their statutory liability assumes this character by

Set-off.
Statutory
liability.

at a discount and set them off at their face in a suit by a creditor. *Gauch v. Harrison*, 12 Ill. App. 459; *Thompson v. Meisser*, 108 Ill. 359; *Thebus v. Smiley*, 110 Ill. 316. When a shareholder pays a debt of the corporation, and takes an assignment, the debt is extinguished, and the shareholders cannot revive it by assigning it. *Hardy v. Norfolk M'f'g Co.*, 80 Va. 404.

¹ *Sawyer v. Hoag*, 17 Wall. 610. See also *Lawrence v. Nelson*, 21 N. Y. 158; *Singer v. Given*, 61 Iowa, 93.

² *Sawyer v. Hoag*, 17 Wall. 610, 622; opinion of court per Miller, J.

³ *Osgood v. Ogden*, 4 Keyes (N. Y.), 70.

⁴ *Osgood v. Ogden*, 4 Keyes (N. Y.), 70, 89; opinion of court per Bacon, J.

virtue of the nature of the proceeding brought to enforce it, a shareholder cannot, against this liability, set off an indebtedness of the corporation to him.¹ "Under a proceeding for winding up a corporation, where an account of all the debts and of the effects, including the aggregate liabilities of the stockholders, is required to be taken, there is no reason why a creditor should be in any better situation on account of being at the same time a stockholder. In the latter character the constitution and the statute make him liable to the creditors to an amount equal to his stock, or to his just proportion of that amount if the whole is not required; but as a creditor he is entitled only to a dividend in proportion to the other creditors. In a case of deficiency in means to pay all the debts, he must take his dividend *pro rata*. But if he could set off his claim as a creditor against his liability as a stockholder, he might be paid in full, while the other creditors would receive only a part of the amount due them."²

§ 732. When, however, a single creditor can and does sue a shareholder at law, to enforce the statutory liability of the latter, it is then competent for the shareholder to set off a debt owing him from the corporation.³ "The statutory liability constitutes a fund which belongs to the creditors to secure the payment of their debts; but it belongs to all the creditors, as well those who are stockholders as those who are not. The defendant as a creditor, has an interest in the fund as well as the plaintiff,

¹ Matter of the Empire City Bank, 18 N. Y. 199; Matthews v. Albert, 24 Md. 527; Hillier v. Allegheny Mut. Ins. Co., 3 Pa. St. 470; Thompson v. Meisser, 108 Ill. 359; Thebus v. Smiley, 110 Ill. 316; Grissell's Case, L. R. 1 Ch. 528; Black & Co.'s Case, L. R. 8 Ch. 254; Callisher's Case, L. R. 5 Eq. 214; Barnett's Case, L. R. 19 Eq. 449. See also Lawrence v. Nelson, 21 N. Y. 158; Emmert v. Smith, 40 Md. 123; Weber v. Fickey, 47 Md. 196. But see, perhaps, contra, Briggs v. Penniman, 8 Cow. (N. Y.) 387; Tallmadge v. Fishkill Iron Co., 4 Barb. 382, 391.

This reasoning is not applicable when the shareholders' liability is unlimited; because each shareholder "is liable to contribute to any amount until all the liabilities of the company are satisfied, and therefore it signifies nothing to the creditors whether the set-off is allowed or not." Grissell's Case, L. R. 1 Ch. 528, 536, per Lord Chelmsford.

² Matter of the Empire City Bank, 18 N. Y. 199, 227; opinion of court per Denio, J.

³ Mathez v. Neidig, 72 N. Y. 100; Jerman v. Benton, 79 Mo. 148. But see Buchanan v. Meisser, 105 Ill. 638.

and his debt was one that would be chargeable against the fund, because it was a debt against the company, for the payment of which stockholders were individually liable, and this would be so irrespective of the question whether the money advanced by the defendant was used to pay obligations for which he was individually liable or not. An action at law cannot be maintained against a stockholder, who is also a creditor to an amount equal to his stock, for the reason that he has an interest in the fund sued for, and it cannot be known but that the whole fund is sufficient to pay all the debts. No accounting can be had, because the proper parties are not before the court."¹

A case recently arose in New York, where the defendant, who was indebted to the corporation for his unpaid subscription, was sued by a creditor to recover, under the Manufacturing Companies Act of 1848, an amount equal to the stock held by the defendant. The corporation was also indebted to the defendant, and this indebtedness he sought to set off in the action brought against him by the creditor. The Court of Appeals held that the defendant could set off only the excess of the indebtedness of the corporation to him over his indebtedness on his unpaid subscription to it; and since, as a matter of fact, the balance was in favor of the corporation, the set-off was entirely disallowed.²

§ 733. A creditor of a corporation who is also a shareholder cannot ordinarily sue another shareholder at law to recover his debt from the individual statutory liability of the latter. For the same liability affects the plaintiff himself, who accordingly is not entitled to recover his full claim from another shareholder. Contribution from the other shareholders is all that

When shareholder who is also a creditor cannot sue another shareholder at law.

¹ *Mathez v. Neidig*, 72 N. Y. 100, 104; opinion of the court per Church, C. J. See *Matter of Empire City Bank*, 18 N. Y. 199, 227; *Agate v. Sands*, 73 N. Y. 620.

² *Wheeler v. Millar*, 90 N. Y. 353. Compare *Emmert v. Smith*, 40 Md. 123; *Weber v. Fickey*, 47 Md. 196. As against the liability as shareholder,

under this New York statute, shareholders who are also trustees cannot set off the amount which they have paid to extinguish their liability as trustees to creditors, under another section of the same statute, for failure to file an annual report. *Veeder v. Mudgett*, 95 N. Y. 295.

he is entitled to; and only a court of equity is competent to adjust the rights of the plaintiff and defendant.¹ It has even been held that a creditor, who is also a shareholder, is estopped from enforcing the individual liability of another shareholder, when such liability arises on a default in the responsibility for which both plaintiff and defendant share.²

If, however, one shareholder is, as against a certain other shareholder, entitled to the full amount of a debt due the former from the corporation, there is no reason why he should not sue the other shareholder at law. Thus, where a statute provides that all shareholders shall be severally individually liable to creditors to the amount of unpaid stock held by them respectively, a creditor may maintain an action at law against a shareholder; even though the former is also a shareholder, provided his stock is paid in full.³

¹ *Thayer v. Union Tool Co.*, 4 Gray, 75; *Bailey v. Bancker*, 3 Hill (N. Y.), 188; *Richardson v. Abendroth*, 43 Barb. 162; *Beers v. Waterbury*, 8 Bosw. (N. Y.) 396; *Thompson v. Meisser*, 108 Ill. 359. See *Bisset v. Kentucky Riv. Nav. Co.*, 15 Fed. Rep. 353. Compare *Clark v. Myers*, 11 Hun, 608. But it has been held that an assignee of a judgment obtained in a suit against the corporation, of which the plaintiff in the suit was a shareholder, may sue a shareholder at law. *Woodruff, etc. Iron Works v. Chittenden*, 4 Bosw. (N. Y.) 406. But see *Potter v. Stevens Machine Co.*, 127 Mass. 592.

The New York courts rest their decisions on the not altogether satisfactory grounds that plaintiff and defendant are partners. A moment's consideration will show that even when a shareholder sues his corporation and obtains from it the payment of his demand, he does not in reality obtain the face of his debt; for the corporate assets in which he is interested as a

shareholder are so much diminished by the satisfaction of his claim as a creditor. Only when one shareholder sues another, then it is apparent that he is not entitled to the full amount of the debt.

² *Potter v. Stevens Machine Co.*, 127 Mass. 592. See § 701, note.

³ *Smith v. Londoner*, 5 Colorado, 365. A shareholder in a corporation, to the members of which personal liability attached, became bankrupt. He pledged with one of his creditors some bonds of the company which itself had become insolvent. The assignee in bankruptcy disputed the creditor's title, but settled and gave up all claim to the bonds, the creditor agreeing to indemnify the assignee from any liability as shareholder in the company. The creditor then sued on the bond to enforce the individual liability of the shareholders. His agreement to indemnify the assignee was set up in defence. But the defence was held bad, as the agreement was only an agreement to indemnify the assignee,

§ 734. When the shareholders are made liable only for debts of a particular class, as for money due employes, they may plead that the debt sued on does not come within that class.¹ For instance, by a New York statute stockholders are made liable for all debts due "labourers, servants, and apprentices, for services performed for such corporation." The Court of Appeals hold that the services referred to are menial or manual; and that he who performs them must be of a class whose members usually look to the reward of a day's labor or service for immediate or present support, from whom the company does not expect credit, and to whom its future ability to pay is of no consequence; one who is responsible for no independent employment, but does a day's work or a stated job under the direction of a superior. Accordingly, a bookkeeper who "worked by the year," and often acted as manager, is not in this category,² nor an assistant chief engineer.³ So where shareholders are made liable for the "debts" of the corporation a shareholder may plead that the claim of

Liability
for debts of
a particular
class.
"Debts."

who was not liable as a shareholder, it was no agreement to indemnify the bankrupt. *American File Co. v. Garrett*, 110 U. S. 288.

¹ *Wakefield v. Fargo*, 90 N. Y. 213; *Conant v. Van Schaick*, 24 Barb. 87; *Larrabee v. Baldwin*, 35 Cal. 155. Compare *Wilson v. Shareholders*, 43 Pa. St. 424.

² *Wakefield v. Fargo*, 90 N. Y. 213. Compare *Short v. Medberry*, 29 Hun, 39. The right of action under this statute is assignable. *Oneida Bank v. Ontario Bank*, 21 N. Y. 490. A suit in equity against all the other shareholders is the proper means of enforcing contribution when a shareholder has paid wages of an employe. *Clark v. Myers*, 11 Hun, 608. So a travelling salesman was held not to be a laborer. *Jones v. Avery*, 50 Mich. 326. See *Sleeper v. Gordium*, 67 Wis. 577, for a construction of a statute of this nature.

The liability of shareholders to creditors, to the extent of their unpaid subscriptions, is not excluded by the existence of a statute rendering shareholders individually liable to the amount of stock held by each of them, for all work or labor done, or materials furnished to carry on the operations of the corporation; even though the claims of the judgment creditors suing to enforce the payment of the unpaid subscriptions arose from labor done and materials furnished. *Bunn's Appeal*, 105 Pa. St. 49.

³ *Brockway v. Innes*, 39 Mich. 47; nor a railroad contractor, *Peck v. Miller*, 39 Mich. 594. A corporation cannot be an "employe" of another corporation within the purview of a statute making shareholders liable for debts due employes. *Dukes v. Love*, 97 Ind. 341.

the creditor is not a "debt" in the sense in which the term is used in the statute. Thus, a judgment against a corporation for personal injuries is not a "debt contracted" by it.¹

§ 735. Shareholders may also plead that their individual liability has been waived in respect of the claim on which suit is brought against them,² or that the statutory provision on which rests their liability had been repealed either before they became shareholders,³ or before the debt on which suit is brought was contracted;⁴ or that the statutory liability was created after the debt was contracted by the corporation, and repealed before suit was brought against the shareholder.⁵ And when a statute on failure to comply with which shareholders are made liable has been substantially complied with, this, where the creditor is not injured, may absolve a shareholder from liability.⁶

§ 736. When, according to the construction put on the statute, the individual liability of shareholders is primary or coördinate with that of the corporation, and not contingent on the inability of the creditor to satisfy his claim from the corporate assets, the statute of limitations begins to run from the time when the debt matures against the corporation.⁷ And under a statute providing that "if any loss or deficiency of the capital stock in any bank shall arise from the official mismanagement of the directors, the stockholders at the time of such mismanagement shall in their individual capacities be liable to pay the same," the Massachu-

¹ *Bohn v. Brown*, 33 Mich. 257; *Hacock v. Sherman*, 14 Wend. 58; *Doolittle v. Marsh*, 11 Neb. 243. Compare *Dryden v. Kellogg*, 2 Mo. Ap. 87. See § 773.

² *French v. Teschemaker*, 24 Cal. 518; *Basshor v. Forbes*, 36 Md. 154. See *Brown v. Eastern Slate Co.*, 134 Mass. 590.

³ *Ochiltree v. Railroad Company*, 21 Wall. 249.

⁴ But where bonds were issued by a corporation while personal liability attached to its shareholders, the holder of them, though he became such after

the repeal of this personal liability, has all the rights of his assignor, including the latter's right of action against the shareholders. *Blakeman v. Benton*, 9 Mo. App. 107.

⁵ *Jerman v. Benton*, 79 Mo. 148.

⁶ *Booth v. Campbell*, 37 Md. 522.

⁷ *Davidson v. Rankin*, 34 Cal. 503; *Lindsay v. Hyatt*, 4 Edw. Ch. (N. Y.) 97; compare *Allibone v. Hager*, 46 Pa. St. 48. See also *Terry v. McLure*, 103 U. S. 442; *Carrol v. Green*, 92 U. S. 509. But see *Mitchell v. Beckman*, 64 Cal. 117; *Hawkins v. Furnace Co.*, 40 O. St. 507.

setts Supreme Court holds that the statute begins to run from the happening of the loss or deficiency in respect of which the liability exists.¹ If, however, the liability of shareholders is contingent on the inability of the corporation to discharge the debt and the exhaustion of the legal remedies of the creditor against it, then the statute of limitations does not run against the liability of the shareholders until the creditor has had a reasonable time to exhaust his remedies against the corporation.²

§ 737. Where the suit against the shareholder is brought to enforce his statutory liability, and a judgment on the claim of the creditor has been obtained against the corporation,* it is held in some cases that the shareholder may contest the suit as being based on a debt not due from the corporation, thus virtually having the whole matter retried, and compelling the creditor to prove again his original right to recover against the corporation.³ But the

Effect of judgment against the corporation.

¹ *Baker v. Atlas Bank*, 9 Metc. 182.

² *Longley v. Little*, 26 Me. 162. See *Handy v. Draper*, 89 N. Y. 334.

Where a statute enacts that when "a corporation has unlawfully made a division of its property, or has property which cannot be attached or is not by law attachable, any judgment creditor may file a bill in equity" to obtain the satisfaction of his debt from such property, the right of action conferred does not accrue until the return of execution unsatisfied; and not till then does the statute of limitations begin to run. *Taylor v. Bowker*, 111 U. S. 110.

When a bank charter contains provision making shareholders liable for the "ultimate redemption of the bills," the liability of the shareholders arises when the bank refuses to redeem or becomes notoriously insolvent, and from that time the statute of limitations runs in favor of the shareholders. *Terry v. Tubman*, 92 U. S. 156.

See *Godfrey v. Terry*, 97 U. S. 171; *Long v. Bank of Yanceyville*, 90 N. C. 405.

When, however, the statute requires suit within a certain time to be begun against the shareholder, that time is not extended by the recovery of judgment against the corporation. *Stilphen v. Ware*, 45 Cal. 110.

³ *Union Bank v. Wando M'g, etc. Co.*, 17 S. C. 339; *Strong v. Wheaton*, 38 Barb. 616; *MacMahon v. Macy*, 51 N. Y. 155; *Miller v. White*, 50 N. Y. 137; *Whitman v. Cox*, 26 Me. 335; *Heard v. Sibley*, 52 Ga. 310. See *Merrill v. Shaw*, 38 Me. 267; *Trippe v. Hunccheon*, 82 Ind. 307; *Neilson v. Crawford*, 52 Cal. 248. Directly opposed to this view are *Holyoke Bank v. Goodman Paper M'fg Co.*, 9 Cush. 576; *Farnum v. Ballard Vale Machine Shop*, 12 Cush. 507; *Robbins v. Justices*, 12 Gray, 225, which hold that when a shareholder, whom creditors intend to hold

weight of authority is, perhaps, in favor of the view that judgment against the corporation can, in a suit by creditors to enforce the statutory liability of shareholders, be impeached by a shareholder only on grounds of collusion or lack of jurisdiction in the court rendering it.¹ This view seems at least well established when the liability sought to be enforced is not statutory, but merely that attaching to shareholders on account of unpaid subscriptions or corporate property improperly received by them.²

§ 738. In a suit brought by a creditor against a shareholder either for unpaid subscriptions, or on account of his statutory liability, the shareholder cannot deny the legal existence of the corporation.³ If the corporation is illegally or irregularly formed, very likely

Shareholder cannot deny corporate existence.

individually, is required to be summoned in the suit against the corporation, he cannot dispute the merits of the claim against it.

¹ *Milliken v. Whitehouse*, 49 Me. 527; *Wilson v. Pittsburgh, etc. Coal Co.*, 43 Pa. St. 424; *Donworth v. Coolbaugh*, 5 Iowa, 300; *Slee v. Bloom*, 20 Johns. (N. Y.) 669; *Lowry v. Parsons*, 52 Ga. 357. See *Black v. Womar*, 100 Ill. 328; *Manufacturing Co. v. Bradley*, 105 U. S. 175; *Singer v. Given*, 61 Iowa, 93. In such case judgment against the corporation is *prima facie* evidence against the shareholder according to *Grund v. Tucker*, 5 Kans. 70; *Schaeffer v. Missouri Home Ins. Co.*, 46 Mo. 248; *Hoagland v. Bell*, 36 Barb. 57.

² *Wetherbee v. Baker*, 35 N. J. Eq. 501; *Bisset v. Kentucky River Nav. Co.*, 15 Fed. Rep. 353; *Clapp v. Peterson*, 104 Ill. 26; *Glenn v. Williams*, 60 Md. 93, 116. Held *prima facie* evidence in *Hastings v. Drew*, 76 N. Y. 9; *Stephens v. Fox*, 83 N. Y. 313.

³ *Casey v. Galli*, 94 U. S. 673;

Eaton v. Aspinwall, 19 N. Y. 119; *Hickling v. Wilson*, 104 Ill. 54; *Danbury and N. R. Co. v. Wilson*, 22 Conn. 435; *McFarlan v. Teuton Ins. Co.*, 4 Denio (N. Y.), 392; *Eppes v. Railroad Co.*, 35 Ala. 33; *Hughes v. Bank of Somerset*, 5 Litt. (Ky.) 47; *Tar River Nav. Co. v. Neal*, 3 Hawks. (N. C.) 520; *McHose v. Wheeler*, 45 Pa. St. 32; *Hammond v. Straus*, 53 Md. 1; *Slocum v. Providence Steam, etc. Co.*, 10 R. I. 112; *Wheelock v. Kost*, 77 Ill. 296; *Central Agricultural Ass'n v. Alabama Gold Life Ins. Co.*, 70 Ala. 120 (the last four cases were actions brought by creditors to enforce statutory liability); *Ossipee Hosiery, etc. Co. v. Canney*, 54 N. H. 295; *Keyser v. Hitz*, 2 Mackey (Dist. of Col.), 473. See §§ 145 *et seq.*, and § 537.

Shareholders, who form under a special charter, whereby they render themselves liable to creditors in an amount equal to double the amount of their stock, cannot escape by pleading that the charter contravenes the state constitution. *McCarthy v. Lavasche*, 89 Ill. 270. As against creditors suing

there will be all the more reason and justice in holding persons who purport to be shareholders therein to their full liability.¹ And, although where the capital stock is fixed at a certain amount no action ordinarily lies against a shareholder to enforce his subscription until the entire amount is subscribed for, yet if the directors undertake to organize the company upon a partial subscription of the capital stock, and a subscriber takes part in such organization, knowing that the whole amount has not been taken, and attends corporate meetings at which money is voted and contracts are made for purchases, he will be estopped in a suit by a creditor from pleading that the capital stock had never been fully subscribed for.²

§ 739. On the other hand, persons who have contracted with a *de facto* corporation as a corporation, cannot deny its corporate existence in order to charge its shareholders individually as partners.³ But it is held that when the enabling act under which a corporation is formed provides that a substantial failure to comply with its requirements shall render the shareholders individually liable, and the statute is not complied with, they are primarily liable, and may be sued by a creditor before the corporate assets are exhausted; and this, although the creditor has dealt with the corporation as a corporation.⁴

for unpaid subscriptions a shareholder cannot deny the corporate existence, even when a judgment of ouster has been rendered. *Rowland v. Meader Furniture Co.*, 38 Ohio St. 269.

¹ Thus a shareholder cannot defeat an action by the receiver of his bank to recover the amount of a note given for his stock, by showing that he and other shareholders illegally gave notes for stock instead of paying cash, in fraud of the banking laws. *Farmers' etc. Bank v. Jenks*, 7 Metc. 592. See also *Abbott v. Aspinwall*, 26 Barb. 202.

Nor can a shareholder plead that the corporate enterprise has been abandoned, in an action brought against him by a creditor. *Bish v. Bradford*, 17 Ind. 490.

² *Garling v. Baechtel*, 41 Md. 305.

³ *Stout v. Zulick*, 48 N. J. L. 599; *Merchants', etc. Bank v. Stone*, 38 Mich. 779; *Humphreys v. Mooney*, 5 Colorado, 282; *Second Nat. B'k v. Hall*, 35 Ohio St. 158; *Stafford Nat. B'k v. Palmer*, 47 Conn. 443; *First Nat. B'k v. Almy*, 117 Mass. 476; *Lafin, etc. Powder Co. v. Sinsheimer*, 46 Md. 315. See *Trowbridge v. Scudder*, 11 Cush. 83; *New York Iron Mine v. First Nat. B'k*, 39 Mich. 644. But see *Johnson v. Corser*, 34 Minn. 355, and compare *Foster v. Moulton*, 35 Minn. 458.

⁴ *Clegg v. Hamilton, etc. Grange Co.*, 61 Iowa, 121; *Marshall v. Harris*, 55 Iowa, 182; *Kaiser v. Lawrence Savings Bank*, 56 Iowa, 104; *Eisfield*

Who are
sharehold-
ers as to
creditors.

§ 740. As evidently the most obvious plea which a defendant can interpose, when sued either for unpaid subscriptions or on account of statutory liability, is that he is not a shareholder, it is important to determine the circumstances or conditions which constitute a person a shareholder as to creditors.¹ Where the name of an individual appears on the stock-book of a corporation as a shareholder, the *primâ facie* presumption is that he is the owner of stock, and in an action against him by or on behalf of creditors, the burden of proving that he is not such rests on him.² If, however, the defendant has never consented to become a shareholder, or held himself out as such, or accepted a certificate, he may plead that his name was placed on the books of the corporation without his authority.³ But if a person subscribes for shares, signs the

v. Kenworth, 50 Iowa, 389; see *Smith v. Colorado Fire Ins. Co.*, 14 Fed. Rep. 399. In *Bigelow v. Gregory*, 73 Ill. 197, it is said that there is a difference between corporations formed under a general enabling act, in this respect; that if the provisions of an enabling act are not substantially complied with, the would-be incorporators will be liable as partners. Thus, shareholders have been held liable as partners for contracts made before the articles of incorporation were filed. *Garnett v. Richardson*, 35 Ark. 145; *Ferris v. Thaw*, 72 Mo. 446. *Cresswell v. Oberly*, 17 Ill. App. 281; see § 451, note. Of course persons who engage in business together without taking any steps to incorporate themselves, will be liable as partners, though they have regarded themselves as "stockholders." *Farnum v. Patch*, 60 N. H. 294. And when persons deal as partners through a common agent, and afterwards become incorporated, but do not change their style or manner of doing business, they will be liable as partners for debts contracted in the business to persons who

have had no notice of their incorporation. *Martin v. Fewell*, 79 Mo. 401.

¹ In general these conditions will be the same as those which render a person liable on his subscription to the corporation. See §§ 510 *et seq.*

² *Turnbull v. Payson*, 95 U. S. 418; *Hoagland v. Bell*, 36 Barb. 57; *Rockville, etc. Turnpike Road v. Van Ness*, 2 Cr. C. Ct. 449; *Pittsburgh, W. and R. R. Co. v. Applegate*, 21 W. Va. 172. See *Stratton v. Lyons*, 53 Vt. 130.

A stockholder named in a certificate is liable as such unless he promptly disavow the relation. *McHose v. Wheeler*, 45 Pa. St. 32. If the certificate show the stock subscribed for, but unpaid, it is conclusive as to the liability of the holder to this extent, that he cannot show that the stock was subscribed for by him as an agent of the company, and that such as was owned by him individually was fully paid up. *Allibone v. Hager*, 46 Pa. St. 48.

³ *Mudgett v. Horrell*, 33 Cal. 25; see *Matter of Reciprocity Bank*, 22 N. Y. 10, 17.

articles of association, acts as an officer, and appears as a shareholder on the books, he will not, as against creditors, be permitted to deny that he is such, although no certificate has ever been issued to him.¹ And when sued by a creditor, mere irregularities in becoming a shareholder will not avail the defendant.²

It has also been held that if a person makes a subscription conditioned on an amendment to the charter being obtained from the legislature, and subsequently the corporation is organized without obtaining the amendment, the defendant taking no active part in its organization, he may be held as a shareholder if he pays up a portion of his subscription, and, through his clerk, takes a receipt wherein the corporation receipts for "ten per cent. of his stock in this bank."³

§ 741. One to whom shares have been transferred in pledge or as collateral security for money loaned, but who appears on the books of the corporation as the owner of the shares, is liable to creditors, or for their benefit as a shareholder.⁴ For this the Federal Supreme Court say there are several reasons. "One is that he is estopped from denying his liability by voluntarily holding himself out to the public as the owner of the stock, and his denial of ownership is inconsistent with the representations he has made; another is, that by taking the legal title he has released the former owner; and a third is, that after having taken the apparent ownership, and thus become entitled to receive dividends, vote at elections, and enjoy all the privileges of ownership, it

Transferee
of shares
as collateral
security.

¹ *Wheeler v. Millar*, 90 N. Y. 353. In general a certificate is not essential to constitute a person a shareholder, § 511.

² *Holyoke Bank v. Goodman Paper M'fg Co.*, 9 Cush. 576; *Burr v. Wilcox*, 22 N. Y. 551.

³ *Lehman v. Warner*, 61 Ala. 455. See §§ 517-521, as to conditional subscriptions.

⁴ *National Bank v. Case*, 99 U. S. 628; *Pullman v. Upton*, 96 U. S. 328; *Adderly v. Storm*, 6 Hill (N. Y.), 624; *Roosevelt v. Brown*, 11 N. Y.

148; *Holyoke Bank v. Burnham*, 11 Cush. 183; *Magruder v. Colston*, 44 Md. 349; *Crease v. Babcock*, 10 Metc. 525; *Wheelock v. Kost*, 77 Ill. 296; *Hale v. Walker*, 31 Iowa, 344; *Bowden v. Farmers', etc. Bank*, 1 Hughes, 307; *Erskine v. Loewenstein*, 82 Mo. 301. *Semble*, contra, *McMahon v. Macy*, 51 N. Y. 155. So as an executor holding shares may be chargeable with the individual liability of his testator. *Diven v. Duncan*, 41 Barb. 520. Compare Rev. St. § 5152.

would be inequitable to allow him to refuse the responsibilities of a shareholder."¹

In a recent Missouri case, *Griswold v. Seligman*,² it was decided that the defendants were liable to creditors as shareholders, where they held a certificate of stock absolute on its face; although the stock in the resolution of the directors in pursuance of which it was issued, was expressed as "in trust," and on the stock books appeared as "in escrow." The defendants had voted on it and elected their own officers to control the corporation. The same court held more explicitly in a subsequent case³ against the same defendants, that in order to sustain the claim of a right by contract to vote on stock without incurring the obligations of a shareholder, it must appear that, at the time when the stock was voted on, there was a contract in force authorizing the holder to vote on it. And hence, where the corporation deposited its own unpaid and unsubscribed stock with a banking firm to be held as collateral security for a year, with no provision for voting on the stock; and after the lapse of a year the firm did vote on it, elected their own directors and obtained control of the corporation, they became liable as shareholders.

A mere pledgee of shares, however, who is not registered as owner, and never receives dividends or exercises any of the rights of a shareholder, is not liable as a shareholder to creditors of the corporations.⁴ Thus it is held by the Federal Supreme Court that a pledgee of shares in the stock of a national bank, who in good faith while the bank is not in failing circumstances, takes the transfer in the name of an irresponsible

¹ *National Bank v. Case*, 99 U. S. 628, 631. Brokers who purchase shares and cause themselves to be registered on the books of the company as shareholders, are liable as shareholders, although the shares be purchased for a customer. *McKim v. Glenn*, 66 Md. 479.

² 72 Mo., 110.

³ *Fisher v. Seligman*, 75 Mo. 13; compare *Bray v. Seligman*, ib. 31. These Missouri cases were not followed

by the Federal Supreme Court in construing the same facts and the same statutes; and the same defendants were held not liable. *Burgess v. Seligman*, 107 U. S. 20. In respect of Federal Courts following state decisions, in construing a state statute, see *Flash v. Conn*, 109 U. S. 371.

⁴ *Anderson v. Philadelphia Warehouse Co.*, 111 U. S. 479; *Henkle v. Salem M'f'g Co.*, 39 O. St. 547.

person, for the avowed purpose of avoiding liability as a shareholder, and who never exercises any rights of a shareholder or receives any dividends, incurs no liability as a shareholder to the creditors of the bank. The dividends were paid to the pledgor, the real owner.¹

§ 742. On the other hand, if a person is the real owner of shares, and, as between himself and the apparent holder, entitled to the profits thereof, it will not avail him as a defence against creditors that the shares did not stand in his name.² And thus a person cannot escape liability as a shareholder by taking his shares in the name of an infant.³

Real owner
of shares
liable.

§ 743. Summing up, the rationale of the preceding decisions may be said to be this. Any person who appears to be a shareholder, or any person who is actually entitled to the emoluments of shares in a corporation, is liable as a shareholder to creditors.⁴

Rationale.

§ 744. When, after the insolvency of the corporation, suit is brought by or on behalf of creditors against shareholders, either on their statutory liability or for unpaid subscriptions, the latter cannot successfully plead that they were induced to subscribe by fraudulent misrepresentations on the part of the corporation or its officers or agents.⁵

Fraud,
when no
defence.

§ 745. It is in view of the right of shareholders to contribution among themselves, that the English courts hold that directors cannot release shareholders from liability, except in accordance with the provisions of

Releases
no defence.

¹ *Anderson v. Philadelphia Warehouse Co.*, 111 U. S. 479. The court said that the creditors of the bank were put in no worse position by the transfer than they would have been in had the shares remained in the name of the pledgor.

² See *Burr v. Wilcox*, 22 N. Y. 551; *Stover v. Flack*, 30 N. Y. 64.

³ *Roman v. Fry*, 5 J. J. Marsh. (Ky.) 634. See also *Cox's Case*, 4 De G. J. & S. 53; *Pugh & Sharman's Case*, L. R. 13 Eq. 566; *Richardson's*

Case, L. R. 19 Eq. 588. Compare *Maxwell's Case*, 24 Beav. 321.

⁴ See § 749, as to colorable transfers.

⁵ *Ogilvie v. Knox Ins. Co.*, 22 How. 380; *Upton v. Tribilcock*, 91 U. S. 45; *Schaeffer v. Missouri Home Ins. Co.*, 46 Mo. 248; *Upton v. Englehart*, 3 Dill, 496; *Turner v. Grangers' Life Ins. Co.*, 65 Ga. 649. See § 525; compare *Weber v. Fickey*, 52 Md. 500.

the deed of settlement.¹ But in America, it is recognized to be the right of creditors that no shareholder shall be released from his liability except in accordance with the constitution of the corporation.² "It must also be conceded that if the company has, in fraud of its creditors, released subscribers to its stock from the payment of their subscriptions, the release is inoperative to protect those subscribers against claims of the creditors. . . . It has been settled by very numerous decisions that the directors of a company are incompetent to release an original subscriber to its capital stock, or to make any arrangement with him by which the company, its creditors or the state, shall lose any of the benefit of his subscription. Every such arrangement is regarded in equity not merely as *ultra vires*, but as a fraud upon the other shareholders, upon the public, and upon the creditors of the company."³ When a subscription payable in property is made for shares, it is no defence to a suit by

¹ See *Directors, etc. v. Kisch*, L. R. 2 H. L. 99; *Smith's Case*, L. R. 2 Ch. 604.

² *Slee v. Bloom*, 19 Johns. (N. Y.) 456; *Eisenlord v. Oriental Ins. Co.*, 29 N. J. Eq. 437; *Allen v. Montgomery R. R. Co.*, 11 Ala. 437, 450; *Mann v. Cooke*, 20 Conn. 178; *Peychaud v. Hood*, 23 La. Ann. 732; *Putnam v. New Albany*, 4 Biss. 365; compare *Cooper v. Federick*, 9 Ala. 737. Thus, an unauthorized cancellation of a subscription when the corporation is insolvent, does not as to creditors release the subscriber. *Rider v. Morrison*, 54 Md. 429. So the withdrawal of shareholders, in pursuance of a resolution of the directors in a probably insolvent corporation to allow shareholders to withdraw on payment of five per cent. of their shares on which ninety per cent. was unpaid, is void as to creditors. *Gill v. Balis*, 72 Mo. 424. A shareholder, however, who surrenders unpaid stock to a corporation is not liable thereon

to a creditor whose claim accrues after the surrender. *Johnson v. Lullman*, 15 Mo. App. 55; S. C., 88 Mo. 567; *Ersine v. Peck*, 13 Mo. App. 280.

On the other hand, a majority of shareholders cannot by a by-law impose individual liability on shareholders. *Reid v. Eatonton M'fg Co.*, 40 Ga. 98.

³ *Burke v. Smith*, 16 Wall. 390, 394, per Strong, J. Where shareholders were by statute individually liable to the amount of the unpaid balance on their subscriptions, for corporate debts contracted during their ownership of stock, and it was provided that such liability should continue for one year after a transfer, it was held that a *solvent* corporation could not release a shareholder so as to affect creditors, even in consideration of a payment by him of an amount in excess of the calls made or due at the time of his release. *Vick v. La Rochelle*, 57 Miss. 602.

creditors against the subscriber, that the corporation has returned the property and the subscriber has released all claim to the shares.¹

§ 746. A *bona fide* compromise between a shareholder and the corporation has, however, been sustained.² And if the company actually forfeits the shares for non-payment of calls, creditors cannot hold the person whose shares have been forfeited liable for the remaining instalments, unless the forfeiture was collusive.³

Compromises.
Forfeitures.

§ 747. Upon a transfer of shares made in accordance with the constitution and by-laws of the corporation, the liability of a shareholder to creditors ordinarily ceases;⁴ and the transferee succeeds to all the rights and liabilities of the transferor.⁵ The transfer, however, in order to free the transferor from further liability on account either of unpaid subscriptions or statutory liability, must be absolute so that the transferee does not become a trustee for the transferor;⁶ and, moreover, must be to a person capable of succeeding to all the liabilities of the transferor. Accordingly, a transfer to an infant leaves the transferor liable,⁷

Effect of transfers of shares. Transfer to corporation.

¹ *Singer v. Given*, 61 Iowa, 93. But it is held that a shareholder who surrenders unpaid shares to the corporation is not liable thereon to creditors whose claims accrue after such surrender. *Johnson v. Lullman*, 88 Mo. 567.

² *New Albany v. Burke*, 11 Wall. 96. See *Gelpke v. Blake*, 19 Iowa, 263, 267; but compare *Putnam v. New Albany*, 4 Biss. 365.

³ *Mills v. Stewart*, 41 N. Y. 384; *Allen v. Montgomery, etc. R. R. Co.*, 11 Ala. 437.

⁴ *Huddersfield Canal Co. v. Buckley*, 7 T. R. 36; *Cole v. Ryan*, 52 Barb. 168. Except according to the cases holding otherwise in regard to statutory liability. See § 718.

⁵ *Hartford and N. H. R. R. Co. v. Boorman*, 12 Conn. 530. Transferee

is liable to creditors for unpaid subscriptions. *Webster v. Upton*, 91 U. S. 65. See §§ 719, 720.

⁶ *National Bank v. Case*, 99 U. S. 628; *Davis v. Stevens*, 17 Blatchf. 259. To relieve a stockholder in a manufacturing corporation from personal statutory liability, his stock must have been transferred on the books of the company, and such transfer must have been made in pursuance of an actual *bona fide* sale, without any secret understanding or trust in favor of the transferor. *Veiller v. Brown*, 18 Hun, 571.

⁷ *Symon's Case*, L. R. 5 Ch. 298; *Weston's Case*, ib. 614; *Costello's Case*, L. R. 8 Eq. 504. See *Reaveley's Case*, 1 De G. & Sm. 520; S. C., aff'd 1 Ha. & Tw. 168; *Richardson's Case*, L. R. 19 Eq. 588.

as does a transfer to the corporation or its nominee;¹ for it is held that the person succeeding to the liability of the transferrer must be one who succeeds to a personal liability distinct from and in addition to that of the corporation; some one who can assume the full liability of a shareholder.²

§ 748. If a transfer is irregular, as, for instance, not recorded on the books of the company, when that formality is required, the transferrer is not freed from his liability;³ though it does not follow that no liability attaches to his transferee.⁴ Creditors are entitled to treat as shareholders all persons whose names appear on the books of the corporation; and until the name of a shareholder is removed from those books, a creditor is justified in acting on the assumption that that person is a shareholder. It has been held, however, that when a person has done "all in his power" to

¹ Morgan's Case, 1 De G. & Sm. 750; Bennett's Case, 5 De G. M. & G. 284; Zulueta's Claim, L. R. 5 Ch. 444; Richmond's Exrs. Case, 2 De G. & Sm. 244; *Ex parte* Henderson, 19 Beav. 107; Daniell's Case, 22 Beav. 43; Munt's Case, *ib.* 55; Eyre's Case, 31 Beav. 177. But these are English cases; and in England a corporation cannot purchase its own shares. See also cases in following note, and § 552.

² Matter of Reciprocity Bank, 22 N. Y. 9. See *Currier v. Lebanon Slate Co.*, 56 N. H. 262. See § 134.

A person who is a creditor at the time of the transfer to the corporation, may follow the property received by the shareholder in exchange for his shares, and subject it to the satisfaction of the full amount of his claim. The defendant may have equities over against other shareholders; but this fact the creditor need not heed. *Clapp v. Peterson*, 104 Ill. 26.

³ *Richmond v. Irons*, 121 U. S. 27; *Worrall v. Judson*, 5 Barb. 210;

Shellington v. Howland, 53 N. Y. 371; *Dane v. Young*, 61 Me. 160; *Fowler v. Ludwig*, 34 Me. 455; *Cutting v. Damerel*, 23 Hun, 339; *In re Bachman*, 12 Nat. Bankr. Reg. 223. Compare *Jones v. Dunn*, 70 Ala. 164; *O'Brien v. Cummings*, 13 Mo. App. 197.

⁴ "So far from its being necessary to make a man a contributory, that he should be *modo et forma* a member according to the strict provisions of the deed of settlement, that on the contrary, if a man, by representations that he is entitled to be registered, becomes registered and admitted *de facto* as a shareholder, he is not at liberty as against those who do not dispute his liability, to refer to or insist on any invalidity as a ground for not being treated as a shareholder. So, if the directors themselves do an irregular act, and admit a man and treat him as a shareholder, they are also bound." *Straffon's Exr's Case*, 1 De G. M. & G. 576, 594, per Lord Chan. St. Leonards.

have his name removed from the company's books, he is freed from liability, although, in fact, his name continues there.¹ This decision seems of doubtful correctness. It is submitted the shareholder did not do all he could to have his name removed, for he could have appealed to the courts; and if in the mean time any one acted on the faith of his being a shareholder, the loss should fall on the shareholder whom the corporation represents, rather than on an innocent outsider.²

§ 749. When shares are not fully paid up and the corporation is in failing circumstances, it is the general rule throughout the United States, that the holder cannot validly transfer them to an irresponsible person for the purpose of avoiding further liability in regard to them. The right of transfer cannot be exercised in defraud of creditors of the corporation.³ A similar rule applies to transfers of shares in the stock of a corporation whose shareholders are by statute rendered personally liable to creditors.⁴

Transfers
in fraud
of credi-
tors.

The English cases, on the other hand, hold that a shareholder may transfer his shares to an irresponsible person for the sole purpose of freeing himself from further liability on them; and, provided the transfer be absolute, so that, as between transferrer and transferee, the latter does not hold the shares in trust for the former, the transferrer will be freed from further liability.

¹ *Shortridge v. Bosanquet*, 18 Beav. 84; but in this case there had been collusion between the plaintiff and directors. See *Whitney v. Butler*, 118 U. S. 655; *Nation's Case*, L. R. 3 Eq. 77; *Fyfe's Case*, L. R. 4 Ch. 768; *Ward & Garfit's Case*, L. R. 4 Eq. 188.

² See § 525.

³ *Dauchy v. Brown*, 24 Vt. 197; *Nathan v. Whitlock*, 9 Paige (N. Y.), 152; *Marcy v. Clark*, 17 Mass. 330; *Rider v. Morrison*, 54 Md. 429; *Gaff v. Flesher*, 33 Ohio St. 107. See *Angell and Ames on Corp.*, § 535; 2 N. Y. Rev. Stat., 7th ed., 1482.

⁴ *Bowden v. Johnson*, 107 U. S. 251; *Richmond v. Irons*, 121 U. S.

27; *Aultmann's Appeal*, 98 Pa. St. 505; *McLaren v. Franciscus*, 43 Mo. 452; *Provident Savings Ins. v. Jackson Place Skating, etc. Rink*, 52 Mo. 557; *Bowden v. Santos*, 1 Hughes, 158; *Magruder v. Colston*, 44 Md. 349; *Central Agricultural, etc. Ass'n v. Alabama Gold Life Ins. Co.*, 70 Ala. 120. See *Miller v. Great Republic Ins. Co.*, 50 Mo. 55.

Where a general banking law imposed on shareholders individual liability while they continued such, and for one year thereafter; and a creditor of a bank made demand on a shareholder for payment, and the latter requested delay, promising not to transfer his shares, but did secretly and

in respect of the shares.¹ The English law does not recognize the doctrine that corporate funds are held in trust for creditors as well as shareholders, and the English decisions respecting the transfer of shares seem consistent with the general English view of corporation law. Provisions in English deeds of settlement are regarded as existing for the security of shareholders; and creditors are held to derive few rights directly from them. And so, in regard to the "Winding-up Act," Lord Romilly says: "The object of the Winding-up Act was only to settle the equities between the partners in order that when the partnership was wound up, they might obtain contribution from each other."²

§ 750. From what has been said of the relations between creditors and shareholders, it is plain that upon the insolvency or winding-up of a corporation, a creditor has a right to be paid the debt due him prior to any of the rights of shareholders in respect of the corporate funds.³ When a dividend, however, has been duly declared from surplus profits, the capital of the company being left entire, a shareholder is entitled to his portion of the dividend in preference to the claims of creditors; even though he may not call for it until the company has

fraudulently transfer them, it was held that the transfer was void as against such creditor, although his suit was brought more than one year after it had taken place. *Paine v. Stewart*, 33 Conn. 516. Compare also *Marr v. Bank of West Tennessee* 4 Lea (Tenn.), 578.

¹ *Jessopp's Case*, 2 De G. & J. 638; *De Pass's Case*, 4 De G. & J. 544; *Harrison's Case*, L. R. 6 Ch. 286; *King's Case*, ib. 196; *Master's Case*, L. R. 7 Ch. 292; *Williams's Case*, 1 Ch. Div. 576. In the following cases the transfer was held merely colorable, and the transferrer remained liable: *Chinnock's Case*, Johns. (Eng. Ch.) 714; *Hyam's Case*, 1 De G. F. & J. 75; *Costello's Case*, 2 De G. F.

& J. 302; *Budd's Case*, 3 De G. F. & J. 297; *Ex parte Kintrea*, L. R. 5 Ch. 95.

² *In re Philips*, 18 Beav. 629; compare regarding the English view, § 524.

³ *Brewer v. Michigan Salt Ass'n*, 58 Mich. 351. Where a national bank is declared in default by the controller, and a sufficient fund is realized from its assets to pay all claims against it, and leave a surplus, interest should be allowed on claims during the period of administration, before appropriating the surplus to the shareholders. *Chemical Nat. B'k v. Bailey*, 12 Blatchf. 480. See also *Hart's Appeal*, 96 Pa. St. 355; *Lum v. Robertson*, 6 Wall. 277; and compare *Cochran v. Ocean Dry Dock Co.*, 30 La. Ann. Pt. II. 1365.

become insolvent.¹ For the moment a dividend is thus declared, it becomes the property of the individual shareholders.² In a controversy coming before the New York courts, the Erie Railway had declared a dividend and deposited money to pay it with D. S. & Co. Thereafter the company withdrew what remained of such money; and this subsequently passed with the corporate property into the possession of a receiver of the road. Application was made by a shareholder to compel the receiver to pay him the amount of his dividend. It was held that the fund deposited with D. S. & Co. should be regarded as specifically appropriated for the payment of the dividend, and that the shareholders acquired an equitable lien upon such fund to the extent of the amounts to which they were respectively entitled; and that the lien followed the fund into the hands of the receiver.³

§ 751. The dissolution of a corporation does not increase the personal liability of shareholders as towards creditors,⁴ nor make the former liable as partners, even as to debts contracted by the corporate agents after the dissolution, provided there is nothing to show fraud on their part, or an actual intention to transact business as partners.⁵

¹ *Le Roy v. Globe Insurance Co.*, 2 Walker, 66 N. Y. 424. But they will become chargeable as partners

² *Van Dyck v. McQuade*, 86 N. Y. 38. if, knowing of the expiration of the charter, they agree to continue business and appoint one of their number

³ *In re* Petition of Julius Le Blanc, 14 Hun, 8; S. C., aff'd, 75 N. Y. 598. as manager. *National Bank v. London*, 45 N. Y. 410.

⁴ *Tarbell v. Page*, 24 Ill. 46.

⁵ *Central City Savings B'k v.*

CHAPTER XIV.

LEGAL RELATIONS BETWEEN OFFICERS AND CREDITORS OF A CORPORATION.

Liability of officers contracting on behalf of their corporation, §§ 752, 753.	Statutory liability of officers to creditors. Four classes, § 761.
When the contract is <i>ultra vires</i> , § 754.	First class, § 762.
Officers' liability to outsiders for the acts of other agents, § 755.	Second class, § 763.
Responsibility of directors to creditors, § 756.	Third and fourth classes, §§ 764-766.
For misapplication of the corporate funds, § 757.	Liability for failure to file annual reports, §§ 767-771.
For neglect of duty, § 758.	What debts are included in this liability, §§ 772-773.
Director's duties to creditors on the insolvency of the corporation, §§ 759, 760.	Liability for signing false reports, § 774.
	Forms of action. Joinder of parties, § 775.

§ 752. BEFORE entering on the discussion of the legal relations between the officers of a corporation and creditors whose rights in respect of the corporate assets have already accrued, it will be well to notice the relations between officers acting on behalf of the corporation and persons with whom they deal, whose legal relations in respect of the corporate enterprise are first occasioned by their transaction with the officers.

In contracting on behalf of a corporation, its officers owe to the person with whom they contract usually no duties which ordinary agents do not owe to persons with whom they contract on behalf of their principals. The same degree of fairness and good faith is to be observed by officers as is ordinarily required in the dealings between man and man.¹ And in general the

¹ See *Edgington v. Fitzmaurice*, 29 Ch. Div. 459. An officer who states to a person about to sell goods to the corporation that in his opinion the corporation is solvent, will not be liable for his misrepresentation if hon-

responsibility of corporate officers to outsiders for whatever torts the former may commit would be regulated by the rules applicable to the responsibility of ordinary agents under similar circumstances.¹ Thus, if acting on behalf of their corporation, officers commit a fraud or other palpable wrong or tort, there would seem to be no reason why they and their corporation might not be joined as defendants in the same action by the injured person.²

§ 753. It may be stated as a general proposition, drawn from the principles of the law of agency as applicable to officers of corporations, that corporate officers contracting as such in good faith will not be personally liable to the other contracting party, if (1) the other party when contracting knows or ought to know that the officers are acting on behalf of their corporation, and (2) the officers have authority to make the contract, and (3) the contract is made in such form as to bind the corporation, and (4) there are no circumstances leading to the conclusion that the officers intended to make themselves personally responsible.³

estly made, although the corporation was insolvent at the time. *Searight v. Payne*, 2 Tenn. Ch. 175; but will be liable for fraudulent misrepresentations. *Phillips v. Wortendyke*, 31 Hun (N. Y.), 192. If directors knowingly issue spurious stock and borrow money on it as collateral, representing it to be genuine, they are liable to the lender in an action for deceit. *National Exchange Bank v. Sibley*, 71 Ga. 726. So directors issuing bonds falsely purporting to be "first mortgage bonds," are liable for the fraud to an innocent purchaser who buys from the agent in whose hands the directors placed them for sale. *Clark v. Edgar*, 84 Mo. 106.

¹ If the agent of a bank without authority—either because the authority has not been conferred by the bank as a matter of fact, or because the bank has no power under its charter to confer such authority—pays away

its money to the officer of another bank, and the latter officer knows that the agent has no authority to pay the money, and that his bank has no right to take it, he is liable personally to the first bank for the money, whether he has paid it over to his own bank or not. *American Nat. B'k v. Wheelock*, 45 N. Y. Super. Ct. 205.

² See *Hewett v. Swift*, 3 Allen, 420; *Campbell v. Portland Sugar Co.*, 62 Me. 552; *In re Imperial Land Co.*, L. R. 10 Eq. 298; *Wright v. Wilcox*, 19 Wend. 343; *Suydam v. Moore*, 8 Barb. 358; *Phelps v. Wait*, 30 N. Y. 78. But see *Parsons v. Winchell*, 5 Cush. 592.

³ Thus, a treasurer of a corporation, to whose order as such a note is made payable, and who indorses the note "R. Beman, Treasurer," and negotiates it on behalf of the corporation, is not personally liable as indorser. *Babcock v. Beman*, 11 N. Y. 200.

In some states, however, the liability of officers to persons with whom they contract on behalf of their corporation, has been extended by statute.¹

See also *Hicks v. Hinde*, 9 Barb. 528; *Farmers' and Mec. B'k v. Colby*, 64 Cal. 352. But see contra the questionable case of *Heffner v. Brownell*, 70 Iowa, 591.

If the covenants in the body of a sealed instrument are expressed as if made by a corporation directly with the plaintiff, and in the instrument the defendant is not named, but signs, and, with his own seal, seals it as president of the corporation, and on their behalf, an action does not lie on it against him individually. *Hopkins v. Mehaffy*, 11 S. & R. (Pa.) 126. See also *Randall v. Van Vechten*, 19 Johns. (N. Y.) 60; *Aggs v. Nicholson*, 1 H. & N. 165. The officers of a corporation described themselves in a contract as the president, vice-president, secretary, treasurer, and directors of the corporation, and covenanted on behalf of "themselves and their successors in office." They signed and sealed the contract without adding their official titles, and the corporate seal was not attached. *Held*, they were not liable personally. *Whitford v. Laidler*, 94 N. Y. 145. Compare *City of Kansas v. Hannibal and St. Jo. R. R. Co.*, 77 Mo. 180.

But the directors of a joint stock company will be liable if they execute a note in the following form: "On demand, we jointly and severally promise to pay to H. or order, the sum of £250, value received, for and on behalf of the Wesleyan Newspaper Association," "P. S., J. W., Directors." For the word "severally" is equivalent to "personally." *Healey*

v. Storey, 3 Exch. 3. Accord, *Bradlee v. Boston Glass Manufactory*, 16 Pick. 347. See also *Brockway v. Allen*, 17 Wend. 40. A promissory note in the form "I promise to pay," and signed by "E., Pres. and Treas. C. Co.," is the note of E., who is liable thereon, and it is not competent to introduce parol evidence to show that the parties at the time understood the note to be the note of the company. *Davis v. England*, 141 Mass. 587. See *McClure v. Livermore*, 78 Me. 390. So a draft accepted by "E. T. L., Agent," may bind the acceptor personally, where nothing further in the draft appears to show that E. T. L. did not intend to bind himself personally. *Slawson v. Loring*, 5 Allen, 340. And persons who personally covenant in a deed, and execute it with their own signatures and seals, will likely be held personally on the covenants; although, from the general tenor of the deed, it might appear reasonably probable that they executed it as representatives of a corporation. See *Stinchfield v. Little*, 1 Me. 231; *Trippets v. Walker*, 4 Mass. 595.

¹ *E. g.* "Any officer of a corporation making, or professing to make any contract not in writing, in the name of or in behalf of any corporation, of the value of one hundred dollars or less, shall be liable as surety for such corporation upon such contract; and may be sued either with the corporation or separately for a breach thereof." *Battle's Rev. Stat. of N. C.*, p. 266, § 24.

If corporate officers, on behalf of their corporation, enter into a contract which they have no authority to make, yet if, under the circumstances, by the operation of any rule of law,¹ the contract binds the corporation to the other contracting party, the officers will not be personally liable to him, for he has suffered no damage from the fact that in reality the contract was unauthorized. If, however, officers make an unauthorized contract on behalf of their corporation, allowing the other contracting party acting as a reasonable man to infer that they have the requisite authority, and in consequence of their lack of authority, the other party is unable to hold the corporation on the contract, what is their liability to him? Here distinctions must be drawn. The officers may have no authority to contract either (1) because their superior officers or the corporation has not authorized them to make the contract, or (2) because the corporation itself has no power to make such a contract, or (3) both of these reasons may unite.

§ 754. In the first supposed case, the officers would be liable, either on the ground of fraud, or implied warranty of the requisite authority.² In the third supposed case there would usually be present sufficient fraud or misrepresentation of fact on their part to render them liable. In the second case, where the corporate officers may have conceived themselves authorized to make the contract, but the contract is *ultra vires* the corporation, as a rule the officers acting in good faith would not be personally liable; because the powers of a corporation are matters of law with knowledge of which persons dealing with it are affected.³ Accordingly, the

When the contract is *ultra vires*.

¹ See §§ 193, 75.

² Where two directors wrote to a bank saying that they had authorized the manager of the company to overdraw on the company's account, the directors themselves having no authority to overdraw, it was held that they impliedly warranted that the manager had authority, and were personally liable. *Cherry v. Colonial Bank*, 38 L. J. P. C. 49; S. C., L. R. 3 P. C. 24. See *Jefts v. York*, 4 Cush. 371;

S. C., 10 Cush. 392; *Weare v. Gove*, 44 N. H. 196.

³ *Ellis v. Colman*, 25 Beav. 662; *Rashdall v. Ford*, L. R. 2 Eq. 750; *Beattie v. Ebury*, L. R. 7 Ch. 777. *Contra*, *Wilson v. Goodman*, 4 Hare, 54; *Richardson v. Williamson*, L. R. 6 Q. B. 276; *Weeks v. Propert*, L. R. 8 C. P. 427. In the three last cases the person contracting with the officers had executed his side of the contract, and would have been remedied

correct rule seems as follows: if officers contract as such with a person who acts in good faith, believing them to be authorized to make the contract in question, such contracting party cannot hold the officers personally liable if, in order to make out his case, it is necessary for him to base his claim against them on such honest though mistaken misrepresentation of the powers of the corporation as arises by implication from their having executed the contract in its behalf.¹ And even if the representations by the officers of the powers of the corporation were express, nevertheless such representations would be only as to matters of law presumably as much within the knowledge of the other contracting party as of the officers of the company, and so if they were honestly made and did not amount to a warranty, there would still seem to be no sufficient reason for holding the officers personally liable. Still, it is to be borne in mind that probably the contracting parties do not stand on equal footing in regard to actual knowledge of the corporate powers; for the person contracting with the officers as a matter of fact is very likely ignorant of the scope of the corporate powers; with which the officers are just as likely conversant. So it would require but slight evidence in such cases to show fraud on the part of the latter; and, indeed, the rule *ignorantia legis neminem excusat* has been relaxed as between persons who actually are very unequal in their knowledge of the law.² Very likely, moreover, if the contract were in such a form that an intention on the part of the officers to bind themselves personally could in any way be inferred, the fact that the contract was not within the powers of the corporation might strengthen

less had the decision been the other way. Still they seem to the writer to be wrong in principle, and to afford illustrations of hard cases making bad law. See cases in next note.

¹ Abeles v. Cochrane, 22 Kans. 405; Humphrey v. Jones, 71 Mo. 62.

² If the defect of authority arises from a want of legal capacity, and if the parties act under a mutual mistake of the law, and are both equally well informed in regard to the facts, so that

the lender is not misled by any word or act of the agent, he would have no legal remedy against the agent; not in assumpsit, for it was not his contract; not in tort, for he is chargeable with no deceit." Jefts v. York, 10 Cush. 392, 395, per Shaw, C. J. Compare, however, Weare v. Gove, 44 N. H. 196.

² See Wheeler v. Smith, 9 How. 55; Carrugi v. Atlantic Fire Ins. Co., 40 Ga. 135.

the presumption that they intended to make themselves personally liable; since otherwise the contract would be invalid, a result which cannot be presumed to have been intended by the parties.¹

§ 755. An agent is not liable to third persons for the frauds or other tortious acts or omissions of inferior agents, although they may have been appointed by him. If the superior agent fails to use due care in selecting sub-agents or servants, he will be liable to his principal for damages resulting from their dishonesty or inefficiency; but, should parties dealing with such sub-agents or servants suffer injury, the maxim *respondeat superior* would fix the liability therefor on the common principal and not on the superior agent.²

Officers' liability to outsiders for the acts of other agents.

A similar rule applies to directors and other corporate officers. Ordinarily, they would not be liable to outsiders for the wrongful acts of agents of the corporation other than themselves, unless they authorized the wrong, or in some way participated in it, or knowingly derived benefit from it.³ Accordingly, the New York Court of Appeals has held that the facts that the name of a person was published as a trustee of a corporation and a certificate of stock issued to him, were not sufficient to warrant a verdict against him for a fraud perpetrated by other trustees and agents of the corporation.⁴ But should a director lend his name or influence in any manner to promote the fraud of another agent of the company, he would be liable to the persons injured, as by so doing he would make the fraud his own;⁵ and for issuing false certificates of stock, officers of

¹ See *Weare v. Gove*, 44 N. H. 196.

² *Stone v. Cartwright*, 6 Term Rep. 411; *Bath v. Caton*, 37 Mich. 199.

³ *Scott v. Depeyster*, 1 Edw. Ch. (N. Y.) 513; *Weir v. Barnett*, 3 Exch. Div. 32.

But where a person acts as the president of a spurious bank, which never had any legal organization, he may be personally liable for deposits lost through the mismanagement and fraud

of his associates. *Hauser v. Tate*, 85 N. C. 81. A superior officer directing a servant of the corporation to commit a tort is liable to the injured person. *Peck v. Cooper*, 112 Ill. 192.

⁴ *Arthur v. Griswold*, 55 N. Y. 400; *Wakeman v. Dalley*, 51 N. Y. 27. See *Hume v. Commercial Bank*, 9 Lea (Tenn.), 728.

⁵ *Salmon v. Richardson*, 30 Conn. 360; *Morgan v. Skiddy*, 62 N. Y. 319; *Clarke v. Dickson*, 5 Jur. N. S.

a corporation have been held liable to *assignees* of the certificates who purchased them in good faith.¹

§ 756. Coming now to the relations between directors and creditors of the corporation—relations, that is, between directors and persons whose claims against the corporation have already arisen—we shall find the rules heretofore stated not always applicable.

To the extent of creditors' interests, corporate funds are held in trust for creditors as well as shareholders. Consequently, directors having in their charge funds on which creditors have valid claims and equitable liens, but in the management of which creditors have ordinarily no voice, hold a position of trust towards creditors as well as shareholders; and owe it accordingly to creditors to protect their interests, as they owe it to shareholders to protect the interests of the latter.²

The only claim of creditors is to be paid what is due them, and their main right is that the corporate funds shall not be wasted, embezzled, or managed with reckless improvidence, and that those funds shall not, to the injury of the creditors, be applied to purposes manifestly beyond the objects of incorporation. It is, moreover, a duty owed by directors to creditors to use reasonable care to keep the corporation solvent, a duty qualified by the duty of directors towards shareholders to use the corporate funds for the purposes of the corporate enterprise, and by the right of directors in so doing to incur whatever risk may be reasonably necessary.³

And, accordingly, directors will be liable to the persons for whom they hold the funds of the corporation in trust, in the

1029. Subordinate officers concerned may be liable as well as their superiors. *Cullen v. Thomson*, 6 L. T. N. S. 870.

¹ *Bruff v. Mali*, 36 N. Y. 200; see also *Shotwell v. Mali*, 38 Barb. 445; *Cazeaux v. Mali*, 25 Barb. 578; § 696; but compare *Peck v. Gurney*, L. R. 6 H. L. 377.

² Compare *Haywood v. Lincoln Lumber Co.*, 64 Wis. 639; *Sturges v. Knapp*, 31 Vt. 1, 53; *Baxter v.*

Moses, 77 Me. 465; *Hurlbut v. Marshall*, 62 Wis. 590. The managers and treasurer of a savings bank, when charged with malfeasance by its receiver, are to be regarded as trustees for depositors, and the statute of limitations applying to legal actions does not apply. *Williams v. McKay*, 40 N. J. Eq. 189; *Williams v. Reilly*, 41 N. J. Eq. 137.

³ See *Bank of Mutual Redemption v. Hill*, 56 Me. 385.

number of whom creditors are to be included, if they commit either a positive breach of trust by misapplying the corporate funds, or a negative breach by grossly neglecting their duties.¹

§ 757. In the first place, as to the liability of directors to creditors for positive misapplication or mismanagement of the corporate funds: "All creditors have the right to look to it [the capital of the corporation] and to its faithful administration for the payment of their debts . . . and they have an interest in and claim upon the fund set apart by law for their payment, and may hold the directors responsible for its unfaithful distribution, or may follow it into the hands of the distributees who hold it as volunteer recipients, having no rightful claim upon it."² There is no doubt that creditors may follow corporate property into the hands of those who have wrongfully acquired it;³ and of this rule, it is not only a necessary consequent, but, as it were, a neces-

For misapplication of the corporate funds.

¹ *Penn Bank v. Hopkins*, 17 Weekly Notes (Pa.), 49; see cases cited in following notes and text. But in such suits judgment must first be had against the corporation, and unless this is alleged the bill is demurrable. *Van Weel v. Winston*, 115 U. S. 228; *Baxter v. Moses*, 77 Me. 465.

According to some decisions, to render directors liable to creditors, they must have been guilty of some fraudulent or malicious act. *Fusz v. Spaunhorst*, 67 Mo. 256; *Ziun v. Mendel*, 9 W. Va. 580. Two special term cases in New York, both decided by the same judge, go even further, and hold that directors are not liable to creditors even for wilful and fraudulent mismanagement of the corporate assets. *Winter v. Baker*, 34 How. Pr. 183; *Branch v. Roberts*, 50 Barb. 435. But the reasoning in these two cases is palpably erroneous. Moreover, it is submitted that every breach of trust on the part of a trustee, whether it consist in a positive misapplication of the trust

funds, or merely in wilful neglect of the duties of the trust, will be regarded as fraudulent by a court of equity. And it is thought that the weight of authority sustains the proposition in the text. Compare *Lyman v. Bonney*, 101 Mass. 562; *S. C.*, 118 Mass. 222. The position of a treasurer is held to be different; and that he, being a mere ministerial officer having no control over corporate funds, or discretion in paying them out, owes no duties to creditors. *Taylor v. Taylor*, 74 Me. 582. Still, *semble*, he would be liable to creditors if he embezzled the funds, and thereby rendered the corporation insolvent.

² *Gratz v. Redd*, 4 B. Mon. (Ky.) 178, 196, per Ewing, C. J. This case held directors liable to refund to the creditors dividends improperly received by themselves.

³ See §§ 656, 657. And see in particular *Union Nat. Bank v. Douglass*, 1 McCrary, 86; *Jones v. Arkansas Mechanical Co.*, 38 Ark. 17.

sary antecedent, that the directors being the trustees, will, for their wrongful disposal of this property, be personally liable to creditors. Whether a person acquiring trust funds will be liable to account to the beneficiary of the trust, will depend on the circumstances of their acquisition. But the trustee will always be liable to his beneficiary for their wrongful disposal.¹

Accordingly, the directors of a bank who, in order to subserve their personal interests, accept in payment for stock, securities not authorized to be taken, instead of cash, will be personally liable to note-holders and other creditors for the whole amount of the so-called paid-up capital.² Similarly, if the charter of a bank require a certain portion of the capital stock to be paid up in specie before the bank has authority to issue bank notes, and the stock is subscribed, but the specie is not paid, yet the directors nevertheless circulate bank notes, "if the bank fail or become insolvent, the bill-holders and creditors may proceed at once against the directors for a breach of trust in so acting contrary to their duty under the charter."³

If a director of a bank withdraws a large amount of its funds, giving no security, and uses them in his own business, and in consequence thereof the bank becomes insolvent, he will be liable to account to the creditors of the bank for the funds so withdrawn.⁴ But it would seem that directors are not liable to account to creditors for the profits they have made from the use of the corporate funds for their personal advantage, although they might be accountable to shareholders for such profits.⁵

§ 758. Through gross neglect of their duties, directors may render themselves liable to creditors for the frauds or other

¹ The assignees of an insolvent bank may recover damages from the directors for a fraudulent sale by them to the bank of its own stock. *Shultz v. Christman*, 6 Mo. App. 338. In *Railway Co. v. Alling*, 99 U. S. 463, it is said that directors represent creditors.

² *Moses v. Ocoee Bank*, 1 Lea (Tenn.), 398.

³ *Schley v. Dixon*, 24 Ga. 273, 277. A receiver may in the interest of credi-

tors sue directors for such injuries as have accrued to the creditors *ut universi*, through the unlawful management by the directors of the corporate affairs. *Raymond v. Palmer*, 35 La. Ann. 276.

⁴ *Bank of St. Mary's v. St. John*, 25 Ala. 566.

⁵ *Lexington R. R. Co. v. Bridges*, 7 B. Mon. (Ky.) 556.

wrongful acts of officers and agents of the corporation other than themselves, by which creditors have suffered injury. If it is the duty of directors to supervise the actions of each other and of the other officers of the corporation, and through gross neglect of duty on the part of directors, the funds of the corporation are embezzled or wasted by others, as they could not have been had the directors attended to their duties, the delinquent directors will be liable to the persons to whom they owe the duty of supervising the corporate affairs for the loss. This duty directors owe to the corporation as the representative of the interests of all persons in the corporate funds. If the corporation fails to enforce it, or to sue for the damages which a breach of it has occasioned, the shareholders may proceed against the directors.¹ Directors also owe this duty to creditors, since for them as well as for shareholders the corporate funds are held in trust. Consequently, if it can be shown that had it not been for the gross negligence of directors, the wrongful acts of the other officers could not have been committed, all the directors who have been either dishonest or delinquent will be liable for the consequences of such acts to creditors of the corporation who are injured.² If, indeed, it

For neglect
of duty.

¹ See § 694.

² Directors who misappropriate corporate funds or through culpable negligence allow other corporate agents to do so, will be individually liable to judgment creditors, whose executions against the corporation have been returned unsatisfied. *Shea v. Mabry*, 1 Lea (Tenn.), 319. See also *Maisch v. Saving Fund*, 5 Phila. 30; *Penn Bank v. Hopkins*, 17 Weekly Notes (Pa.), 49. When the guilty directors control the corporation no previous demand on the corporation to sue need be alleged. *Ib.* And compare *Robinson v. Smith*, 3 Page (N. Y.), 222.

In an action against the directors of an insolvent bank, the complaint charged that bonds, specially deposited with the bank, were wrongfully taken

by its officers, and by them converted to the use of the bank without authority from the plaintiffs, and that the defendants had, or by the most ordinary diligence and investigation, could have had ample notice of this. The complaint was held good; the following being in substance the views taken by the court. The defendants could not rely on any lack of privity between them and the plaintiffs. In a certain sense, directors are the bank, and the public has a right to expect reasonable care from them. They owe this duty to creditors of the bank. It is the duty of directors to use ordinary diligence to acquaint themselves with the business of the bank, and whatever information might be acquired by ordinary attention to their duties, they

should be held that the creditor himself could not sue in the absence of some enabling statutory provision, he could in case of the insolvency of the corporation—the only case in which his interests ordinarily would have been injured—apply for the appointment of a receiver; whose duty it would then be to sue the delinquent directors, and apply the moneys recovered to the discharge of the corporate indebtedness.¹

§ 759. When a corporation becomes insolvent, the duty of its directors towards its creditors becomes even stricter and more imperative; for, under such circumstances, the rights of creditors are paramount, and it has become probable that they will be somewhat damaged; and the plain duty of directors, who control the funds from which corporate debts are paid, is to see that the loss is as small as possible. Moreover, since, upon the insolvency of the corporation, the rights of unsecured creditors are equal, it would seem to be unlawful, even in the absence of a statute expressly forbidding it, for directors to make preferences among them.² And certainly, when directors are themselves among the number of corporate creditors, they cannot make use of their official position in order to secure to themselves advantages over other creditors in the settlement of the corporate indebtedness. Any such unfair transaction will be set aside at the suit of creditors; and directors will be compelled to account for the ratable benefit of all the creditors, for whatever corporate assets they have taken possession of or assigned to themselves, after

may, in controversies with persons doing business with the bank, be presumed to have. They cannot then be heard to say that they were not apprised of facts shown to exist by the books of the bank, and which would have come to their knowledge except for their gross neglect. It is not necessary in many cases to show that the directors actually had their attention called to the mismanagement of the bank's affairs or to the misconduct of the subordinate officers. It is sufficient to show that the evidence of such mis-

management or misconduct was sufficient to apprise them of it, had they not been grossly negligent or wilfully careless in the discharge of their duties. *United Society of Shakers v. Underwood*, 9 Bush (Ky.), 609.

¹ Compare *Attorney-General v. Guardian Mut. Insurance Co.*, 77 N. Y. 272.

² *Richards v. New Hampshire Ins. Co.*, 43 N. H. 263; *Haywood v. Lincoln Lumber Co.*, 64 Wis. 639. See *Cassery v. Manners*, 9 Hun, 695.

the insolvency of the corporation, for the securing of their own claims.¹ Nor will directors in defence be allowed to plead their own ignorance of the corporate insolvency.² Moreover, when a corporation has been adjudged bankrupt or has become insolvent, if its officers buy up claims against it at a discount, in a settlement of their own statutory liability (as shareholders), they will not be allowed more than they actually paid for such claims.³

§ 760. In *Drury v. Cross*,⁴ a sale was made of the entire property of a railroad company, at a price far below its value, under a scheme between the directors and the purchasers, by which the former escaped liability on certain endorsements made by them for the corporation. At the suit of other creditors the sale was set aside, and the purchasers were held as trustees for the complaining creditors for the full value of the property purchased, less a sum which the purchasers had actually paid for a lien claim, which they had bought at a large discount. Interest on the balance from the time of the purchase to the date of the final decree was also added. So, in *Jackson v. Ludeling*,⁵ where the directors and local managers of an embarrassed railroad company holding a small portion of its bonds obtained a hasty order of sale, and sold out the road, grossly disregarding the interests of the other bondholders, the sale was set aside.⁶

Directors and other officers, however, who are also creditors,

¹ *Hopkins & Johnson's Appeal*, 90 Pa. St. 69; *Smith v. Putnam*, 61 N. H. 632; *Wilkinson v. Bauerle*, 41 N. J. Eq. 635; *Haywood v. Lumber Co.*, 64 Wis. 639; *Bradley v. Farwell*, 1 Holmes, 433; *Corbett v. Woodward*, 5 Sawyer, 403; *Stout v. Yaeger Milling Co.*, 13 Fed. Rep. 802; *Gas-light Improvement Co. v. Terrell*, L. R. 10 Eq. 168. See *Kingsley v. First Nat. Bk.* 31 Hun (N. Y.), 329; *Contra*, *Planters' Bank v. Whittle*, 78 Va. 737; *Foster v. Mullanphy Plaining Mill Co.*, 16 Mo. App. 150; *Garett v. Burlington Plow Co.*, 70 Iowa,

697. Compare *Duncomb v. N. Y., Housatonic, etc. R. R. Co.*, 88 N. Y. 1; S. C., 84 N. Y. 190; *Bassett v. Monte Christo M'g Co.*, 15 Nev. 293, § 632.

² *Corbett v. Woodward*, 5 Sawyer, 403; *Clay v. Towle*, 78 Me. 86.

³ *Holland v. Heyman*, 60 Ga. 174; *Lingle v. National Ins. Co.*, 45 Mo. 109. But see *Craig's Appeal*, 92 Pa. St. 396.

⁴ 7 Wall., 299.

⁵ 21 Wall., 616.

⁶ See also *James v. Railroad Co.*, 6 Wall., 752.

are of course not excluded, because officers, from sharing ratably with the other creditors of their corporation.¹

§ 761. Throughout the states of the Union many statutes have been passed regulating the relations between directors and creditors of corporations. The majority of them seem to proceed on the theory that corporate funds are trust funds to be managed with due regard for the security of creditors as well as the profit of shareholders; and that in the management of these funds directors are charged with duties to creditors. These statutes may be divided into four classes: the first providing for certain liability of the directors in contract; the second for certain liability of the directors in tort, beyond their common law or equitable liability; the third for certain acts to be performed by the directors; and the fourth forbidding certain acts absolutely or under certain circumstances. By violating statutes of the third and fourth classes, directors either (1) incur specific pecuniary penalties, (2) render themselves individually responsible for certain corporate liabilities, or (3) commit a misdemeanor or felony.

Statutory
liability
of officers
to credi-
tors. Four
classes.

§ 762. The first class of statutes² seem to apply rather to those relations between directors and persons dealing with them which arise directly from the transaction occasioning the claims of such person against the corporation, than to the relations with such persons after the latter have become creditors of the corporation. Statutes of this class create a liability arising through no fault of the directors, but sounding in contract; and to repeal one of them so as to affect the relations between creditors whose debts have already arisen, and directors holding office at the time of the

First
class.

¹ Bristol Milling, etc. Co. v. Probasco, 64 Ind. 406. See Christian's Appeal, 102 Pa. St. 184.

² Illustrations: "The officers and stockholders of every corporation or association for banking purposes, issuing bank notes or paper credits to circulate as money, shall be individually liable for all debts contracted during the term of their being officers or

shareholders of such corporation or association, equally and ratably to the extent of their respective shares of stock in such corporation or association." Cons. of Mich., art. xv. § 3.

"The trustees of a corporation created for a purpose other than profit, shall be personally liable for all debts of the corporation by them contracted." Rev. Stat. of Ohio, § 3261.

repeal would conflict with the Federal Constitution.¹ Many of them create a liability of directors as shareholders, and indeed seem hardly applicable to directors as such.

§ 763. A single instance of statutes of the second class will suffice: "The directors or trustees of corporations . . . shall be jointly and severally liable to the creditors and shareholders for all moneys embezzled or misappropriated by the officers of such corporations . . . during the term of office of such directors or trustees."² This statute, which creates a liability on the part of directors for wrongful acts of other corporate agents far in excess of any common law or equitable liability, apparently proceeds on the idea that it is a duty, for the non-fulfilment of which a director would be liable to all persons interested, to see that the corporate funds are not misapplied. In fact, it makes him an insurer against their misapplication. And a director held to the liability imposed by a statute of this nature, himself innocent of all misfeasance, would seem entitled to contribution from his co-directors.³

Second
class.

§ 764. The statutes of the third and fourth classes, whether positive—commanding—or negative—forbidding—are of essentially the same character, *i. e.*, penal; and this, too, whether the penalty consists in (1) a specific sum of money, (2) creation of general liability on the part of directors for corporate debts, or (3) in making certain acts or omissions felonies or misdemeanors.⁴ From the view that

Third and
fourth
classes.

¹ See *Hawthorne v. Calef*, 2 Wall., 10; *Corning v. McCullough*, 1 N. Y. 47.

² Cons. of California, 1879, art. xii. *Crown v. Brainerd*, 57 Vt. 625.

§ 3. ⁴ *Wiles v. Suydam*, 64 N. Y. 173;

³ See *Ashhurst v. Mason*, L. R. 20 Eq. 225. Where by statute directors are liable "to the creditors and stockholders of said corporations for any loss which may be sustained in consequence of any incompetency, unfaithfulness, or remissness in the discharge of their official duties . . . and any number of such directors may be sued

in the same action by any claimant under these provisions;" the action must be brought in a court of equity.

First Nat. Bank v. Price, 33 Md. 487;

Sturges v. Burton, 8 Ohio St. 215;

Breitung v. Lindauer, 37 Mich. 217;

Kritzer v. Woodson, 19 Mo. 327;

Gregory v. German Bank, 3 Col. 332;

Union Iron Co. v. Pierce, 4 Biss. 327;

Irvine v. McKeon, 23 Cal. 472;

Nassau Bank v. Brown, 30 N. J. Eq.

478, 484; *Stebbins v. Edmands*, 12

statutes of these two classes are penal, important consequences follow. First, they will not be enforced outside of the state enacting them.¹ Secondly, when the liability of a director under one of these acts is enforced against him, it seems that he will have no action for contribution against his co-directors;² and thus the "joint and several" liability of directors under these statutes may mean little more than they may be joined as defendants. Thirdly, these statutes are to be construed strictly.³ Fourthly, a repeal of them even so as to affect existing debts is constitutional;⁴ for there can be no vested right to recover a penalty.⁵ And, finally, the liability which they impose will not survive the death of the delinquent director, unless reduced to judgment before that event.⁶

§ 765. The courts of all the states, however, have not been unanimous in holding statutes of these two classes to be penal, when, by violating one of them directors render themselves liable for the debts of the corporation. In *Neal v. Moultrie*,⁷ it was held that the liability, being created in favor of individuals, could not constitute a penalty. But the pertinency of this reasoning is not clear. In *Hargroves v. Chambers*,⁸ it was said that the liability of the directors would not be affected by the extinguishment of the debt as to the corporation; which

Gray, 203; *Billings v. Trask*, 30 Hun (N. Y.), 314; *Gadsden v. Woodward*, 103 N. Y. 242. See § 771.

¹ *First Nat. Bank v. Price*, 33 Md. 487; *Derrickson v. Smith*, 27 N. J. L. 166; *Halsey v. McLean*, 12 Allen, 438; *Bird v. Hayden*, 2 Abb. Pr. N. S. (N. Y.) 61; S. C., 1 Robt. (N. Y.) 383; *Veeder v. Baker*, 83 N. Y. 156. See *Story*, *Confl. of Laws*, §§ 620, 621; *Whart. Confl. of Laws*, §§ 853 *et seq.*; and compare § 393 *ante*.

² *Andrews v. Murray*, 33 Barb. 354. *Contra*, *Nickerson v. Wheeler*, 118 Mass. 295. See §§ 767, 805.

³ *Bonnell v. Griswold*, 80 N. Y. 128; *Steam Engine Co. v. Hubbard*, 101 U. S. 188; *Gray v. Coffin*, 9 Cush. 192; *Chase v. Curtis*, 113 U.

S. 452. See *Pier v. Hanmore*, 86 N. Y. 95. Compare *Western Union Tel. Co. v. Hamilton*, 50 Ind. 181. Judgment against the corporation is not even *prima facie* evidence in an action against the directors to charge them with the debts of the corporation for their failure to file a report. *Miller v. White*, 50 N. Y. 137.

⁴ *Breitung v. Lindauer*, 37 Mich. 217; *Union Iron Co. v. Pierce*, 4 Biss. 327; *Gregory v. German Bank*, 3 Col. 332.

⁵ *Yeaton v. United States*, 5 Cranch, 281; *Norris v. Crocker*, 13 How. 429.

⁶ *Mitchell v. Hotchkiss*, 48 Conn. 9. See § 771.

⁷ 12 Ga. 104.

⁸ 30 Ga. 580.

last is opposed to the New York case of *Jones v. Barlow*.¹ Certain it is, however, that some of these statutes come near creating a liability sounding in contract. For instance, it would be hard to construe the following as creating a mere penalty: "If a bank shall become indebted beyond the amount allowed . . . the directors . . . shall be liable for the excess in their private capacities, and an action in contract may, in such cases, be brought against them, or any of them; their or any of their heirs, executors, or administrators, by any creditor of the bank; or such creditor may have a remedy by a suit in equity."² Where such a statute as this creates liability on the part of directors only, that may be a reason for presuming the statute to be penal; while a presumption that the liability is of a different nature might arise in some cases where the liability is extended to shareholders, especially if directors are affected only as shareholders.

§ 766. There are finally a few statutes, falling properly under none of the preceding classes, whose object it is, by creating presumptions, to put on the directors the disproof of certain matters which it might be hard for other persons to prove. For instance: "Every insolvency of a chartered bank . . . shall be deemed fraudulent."³ "It is presumed that directors present at a meeting assent to the measures there passed; and that within a certain time, or after such measures are entered on the books of the corporation, absent directors have knowledge of them."⁴

Although it would be beyond the limits of this treatise to discuss in detail the effect of the various statutes which impose liability on directors either for failure to do certain acts which are prescribed, or for doing certain other acts which are forbidden,⁵ still a few illustrations of the more frequent of these statutes and their effect may not be out of place.

§ 767. Enabling acts very commonly require corporations to file annual reports of their condition, and make directors

¹ 62 N. Y. 202.

⁴ California Penal Code, §§ 569,

² General Stat. of Mass. 203, § 27. 570.

³ Georgia Code 1873, § 4428.

⁵ *I. e.*, statutes of the third and fourth classes.

liable for the debts of the corporation on a failure to do so.

Such a requirement is contained in the New York
 Liability for failure to file annual reports. Manufacturing Companies Act of 1848, and many important decisions in regard thereto have been rendered by the New York courts; and, indeed, the section containing the provision is somewhat open to construction.

It is as follows: "Every such company shall, within twenty days from the first day of January¹ . . . make a report which shall be published in some newspaper published in the town, city, or village . . . where the business of the company is carried on, which shall state the amount of capital, and of the proportion actually paid in, and the amount of its existing debts, which report shall be signed by the president and a majority of the trustees, and shall be verified by the oath of the president or secretary of said company, and filed in the office of the clerk of the county where the business of the company shall be carried on, and if any of said companies shall fail to do so, all the trustees of the company shall be jointly and severally liable for all the debts of the company then existing, and for all that shall be contracted before such report shall be made; but whenever under this section a judgment shall be recovered against a trustee severally, all the trustees of the company shall contribute a ratable share of the amount paid by such trustee on such judgment, and such trustee shall have a right of action against his co-trustees, jointly or severally, to recover from them their proportion of the amount so paid on such judgment."²

§ 768. According to this section, as it has been judicially expounded: "Upon default of a company to report, all the trustees then in office are jointly and severally liable for all the debts of the company then existing, whether contracted by them or their

¹ A court cannot by allowing the filing of a report *nunc pro tunc* relieve trustees from the penalty of not filing a report within the twenty days. *Butler v. Smalley*, 101 N. Y. 71.

² Laws of 1848, chap. 40, § 12. Had contribution among the trustees not been specifically provided for, it would seem that one trustee would have had no action over for contribution against his co-trustees, §§ 764, 805.

To an action by a creditor to charge a director with the penalty for a failure to file a report, the director cannot plead that he did not know of the law requiring it, and that the failure was not intentional. *Van Etten v. Eaton*, 19 Mich. 187. Compare *Cooke v. Pearce*, 23 S. C. 239.

predecessors, and for all that may be subsequently contracted during their continuance in office, till such report be made. Trustees who, upon such default, retire from office, are liable for all debts of the company then existing, but for no subsequent ones. Their successors, by promptly obeying the requirements of the statute, may escape all liability; but if they continue the default until the next January, they are liable for the debts contracted during their administration up to that time, and for no other, unless they then and there make default, in which latter case they become liable for all debts then existing. Thus the members of successive boards may become liable for the same debts, by reason of successive defaults."¹

§ 769. Under this statute, trustees are elected for one year, and, unless they hold over and act for the corporation after the expiration of their term of office, they are not liable for a subsequent failure to file a report, although no new trustees are elected.² The mere fact, moreover, that a stockholder is elected a trustee, is not enough to charge him with the penalties for a failure to file a report. There must be evidence of his acceptance of the office.³ And this liability does not arise if a report be filed, although the same is in some respects untrue.⁴

§ 770. To relieve trustees from their duty to file annual re-

¹ Vincent v. Sands, 1 J. & S. (N. Y.) 511, 517. Opinion of the Court per Freedman, J.; S. C., aff'd, 58 N. Y. 673. See Rorke v. Thomas, 56 N. Y. 559; Chambers v. Lewis, 28 N. Y. 454; Boughton v. Otis, 21 N. Y. 261.

² Van Amburgh v. Baker, 81 N. Y. 46. In this case before the expiration of their term the trustees passed a resolution discontinuing business.

If, however, a trustee holds over, and there is a debt contracted while he is a trustee *de facto*, he is liable for a default. Deming v. Puleston, 55 N. Y. 655.

³ Cameron v. Seaman, 69 N. Y. 396; Osborn & Cheeseman Co. v.

Croome, 14 Hun, 164; S. C., aff'd 77 N. Y. 629.

⁴ Bonnell v. Griswold, 80 N. Y. 128. Nor does the liability arise for a failure to state, in accordance with chap. 333 of the laws of 1853, that the stock is issued in payment for property. - *Ib.* Another section of the act of '48 provides penalties for filing an untrue report. See § 774.

Under the section quoted above, which requires the report to be signed by the president and a majority of trustees, it is sufficient if the president with the trustees who sign constitute a majority of the trustees; as the president is a trustee *ex officio*. Glens Falls Paper Co. v. White, 18 Hun, 214.

ports a technical dissolution of the corporation is not requisite. This duty is at an end when the corporation is practically abandoned and has ceased to carry on business; or when its affairs have passed into the hands of a receiver or an assignee in bankruptcy.¹ The action against the trustee must be brought on the original claim of the creditor; and not on a judgment obtained against the corporation, as the latter is not even *prima facie* evidence to charge the trustees with a debt.² The declarations, however, of an officer, relating to matters in which he was competently acting for the corporation, are admissible as evidence against a trustee in an action brought to charge the latter with a debt of the corporation, there having been a failure to file the annual report.³ And in such an action the trustees cannot avail themselves of a defence not personal to themselves, but going to the foundation of the claim against the corporation; unless the corporation itself could have successfully relied on the same defence.⁴ The statute of limitations begins to run in favor of the trustees from the time when the cause of action accrued against them, *i. e.*, from the time of their first failure to file a report,⁵ and successive failures do not prevent the statute from running.⁶

§ 771. A liability of this character being penal does not survive the death of the delinquent trustee, as against his representatives,⁷ nor the death of the plaintiff occurring in the course of the action.⁸ Yet it has been held that if the default

¹ *Kirkland v. Kille*, 99 N. Y. 390; *Losee v. Bullard*, 79 N. Y. 404; *Huguenot Nat. Bank v. Studwell*, 74 N. Y. 621; *Bonnell v. Griswold*, 80 N. Y. 128; *Bruce v. Platt*, *ib.* 379. But compare *Sanborn v. Lefferts*, 58 N. Y. 179.

² *Miller v. White*, 50 N. Y. 137; *Esmond v. Bullard*, 16 Hun, 65; *Chase v. Curtis*, 113 U. S. 452. Compare *Bassett v. St. Alban's Hotel Co.*, 47 Vt. 313. Contra, *Thayer v. New England Lithographic Co.*, 108 Mass. 523.

³ *Hoag v. Lamont*, 60 N. Y. 96.

⁴ *Whitney Arms Co. v. Barlow*, 63 N. Y. 62. For a case where the defendant trustee was allowed to deny that a corporation had ever been organized, see *De Witt v. Hastings*, 69 N. Y. 518.

⁵ *Duckworth v. Roach*, 81 N. Y. 49.

⁶ *Losee v. Bullard*, 79 N. Y. 404.

⁷ *Stokes v. Stickney*, 96 N. Y. 323; *Mitchell v. Hotchkiss*, 48 Conn. 9.

⁸ *Brackett v. Griswold*, 103 N. Y. 425. The cause of action here was not a failure to file the report, but the filing a false report.

occur after the death of the original creditor, the delinquent trustees are liable to his executor.¹ And likewise the right to enforce this liability passes with an assignment of the debt.²

§ 772. Although the language of the New York statute is broad enough to include a debt of the corporation to one of the trustees who are in default, yet such a result is held not to be within its spirit; and neither a delinquent trustee nor a firm of which he is a member can take advantage of a default for which he is in part responsible, to recover against his co-trustees.³ An assignee for value, however, who takes an absolute assignment of a debt of the corporation can maintain an action against the trustees, although his assignor remains a trustee up to the time of the default.⁴

What debts included in this liability.

§ 773. Where on account of a failure to file a report, directors or trustees are made liable for the "debts" of the corporation, corporate liabilities "which may give causes of action against it and result in judgments are not within the statute unless they constitute present debts;" for a debt is "something which may be subject to a suit as a debt, and not something to which the party may be entitled as damages in consequence of a failure to perform a duty or keep an engagement."⁵

§ 774. A provision of the following character is not infrequent in enabling acts. "If any certificate or report made, or public notice given by the officers of any such company, in pursuance of the provisions of this

Liability for signing false reports.

¹ *Carley v. Hodges*, 19 Hun, 187.

² *Pier v. George*, 20 Hun, 210; S. C., aff'd, 86 N. Y. 613.

³ *Knox v. Baldwin*, 80 N. Y. 610; *Briggs v. Easterly*, 62 Barb. 51. See *Adams v. Mills*, 60 N. Y. 533. But a creditor who is also a stockholder, may recover on this liability of the trustees. *Sanborn v. Lefferts*, 58 N. Y. 179.

⁴ *Cornell v. Roach*, 101 N. Y. 373. But compare *Brackett v. Griswold*, 103 N. Y. 425.

⁵ *Lockhart v. Van Alstyne*, 31 Mich.

76, 78, per Cooley, J.; acc. *Cady v. Sanford*, 53 Vt. 632. See *Whitney Arms Co. v. Barlow*, 68 N. Y. 34; *Victory Webb Printing Co. v. Bucher*, 26 Hun, 48. A claim in tort is not a "debt" within the meaning of such a statute. *Chase v. Curtis*, 113 U. S. 452; nor is the liability for damages which arises from the infringement of a patent. *Child v. Boston, etc. Iron Works*, 137 Mass. 516. Compare *Trinity Church v. Vanderbilt*, 98 N. Y. 170. See § 734.

act, shall be false in any material representation,¹ all the officers who shall have signed the same, knowing it to be false, shall be jointly and severally liable for all the debts of the company contracted while they are stockholders or officers thereof.”² Under a provision of this kind, in order to charge the officers signing the false report, some fact must be proved showing bad faith, or wilful and fraudulent intent to deceive, on the part of the officers.³

§ 775. In regard to the form in which actions to enforce the statutory liability of directors should be brought, little of general value can be said; since this is a matter so largely dependent on the terms of the statute itself, as well as on the rules of procedure in force in the different states. It may be said, however, that if the apparent intention of the statute creating the liability is to provide a fund for the security of all the creditors, then, on principles heretofore discussed in relation to the statutory liability of shareholders,⁴ the action should be brought in a court having equitable powers, and on behalf of all creditors who are willing to share in the expense.

Thus, a statute provided that “if the indebtedness of the company shall at any time exceed the amount of its capital stock, the trustees assenting thereto shall be personally and individually liable for such excess to the creditors of the company.” The Federal Supreme Court held that an action at law

¹ See *Butler v. Smalley*, 101 N. Y. 71; which held that knowingly omitting certain liabilities of the company did not make the report “false in any material representation.” Compare *Whitaker v. Masterton*, 106 N. Y. 277.

² Chap. 40 N. Y. Laws of 1848, sec. 15.

³ *Pier v. Hanmore*, 86 N. Y. 95; *Bonnell v. Griswold*, 89 N. Y. 122; *Stebbins v. Edmands*, 12 Gray, 203. See *Arthur v. Griswold*, 55 N. Y. 401; *Waters v. Quimby*, 27 N. J. L. 296.

Where directors are made liable for all debts of the company contracted by them in excess of a certain amount, a director who protests verbally against contracting the debt is not liable. *Schofield v. Henderson*, 67 Ind. 258; *Aimen v. Hardin*, 60 Ind. 119; see *Raber v. Jones*, 40 Ind. 436. Compare in regard to provisions of this kind, *White v. How*, 3 McLean, 111; *Cornwall v. Eastham*, 2 Bush (Ky.), 561; *Irvine v. McKeon*, 23 Cal. 472; *National Bank v. Paige's Executor*, 53 Vt. 452.

⁴ See § 726.

could not be maintained by one creditor among many to enforce for his own benefit the liability thus created; but that the remedy was in equity, since the excess, for which the directors were liable, constituted a fund for the benefit of all the creditors.¹ Justice Miller said, giving the opinion of the court: "The remedy for this violation of duty as trustees is in its nature appropriate to a court of chancery. The powers and instrumentalities of that court enable it to ascertain the excess of indebtedness over the capital stock, the amount of this which each trustee assented to, and the extent to which the funds of the corporation may be resorted to for the payment of the debts; also, the number and names of the creditors, the amount of their several debts: to determine the sum to be recovered of the trustees and apportioned among the creditors, in the manner which trial by jury and the rigid rules of common law proceeding render impossible."²

¹ *Horner v. Heming*, 93 U. S. 228.

² *Horner v. Heming*, 93 U. S. 228, 232. *Accord*, *Merchants' Bank v. Stevenson*, 10 Gray, 332; *Low v. Buchanan*, 94 Ill. 76; *Buchanan v. Bartow Iron Co.*, 3 Ill. App. 191; *Anderson v. Speers*, 21 Hun, 568. See *Peele v. Phillips*, 8 Allen, 86; *Bond v. Morse*, 9 Allen, 471. But see *Cornwall v. Eastham*, 2 Bush (Ky.), 561; *Buell v. Warner*, 33 Vt. 570; *Bassett v. St. Alban's Hotel Co.*, 47 Vt. 313. As to the form of an action at law, see *Union Iron Co. v. Pierce*, 4 Biss. 327.

It has been held that it is not necessary for the creditor to recover a judg-

ment against the corporation before proceeding against the directors to enforce a liability of this nature. *Merchants' Bank v. Stevenson*, 5 Allen, 398. But see *Kinsley v. Rice*, 10 Gray, 325; *Johnson v. Churchwell*, 1 Head (Tenn.), 146.

When on account of paying a dividend out of capital, directors are rendered liable for the debts of the corporation, it has been held that the corporation need not be joined as defendant. The guilty directors have no right of subrogation, and no recourse against the corporation. *Hill v. Frazier*, 22 Pa. St. 320.

CHAPTER XV.

LEGAL RELATIONS AMONG THE SHAREHOLDERS OF A CORPORATION.

Relations discussed, § 776.	Shares more fully paid up, § 787.
Two classes of legal relations between shareholders, §§ 777, 778.	Equal rights of shareholders, § 788.
Right of shareholders that each shall bear his proportion of the corporate burdens, § 779.	Relations between transferrer and transferee, § 789.
Releases. Transfers, § 780.	Specific performance, § 790.
Subscriptions induced by fraud, § 781.	Indemnification of transferrer, § 791.
Changes in the corporate constitution, § 782.	Fraud, § 792.
Contribution among shareholders, § 783.	Warranty by transferrer, § 793.
Where shareholders are also creditors, § 784.	Pledge of shares, § 794.
Classes of shareholders, § 785.	Validity of assignment of stock certificates, § 795.
Rights of preferred shareholders, § 786.	As against assignor's creditors, § 796.
	Stock certificates "in trust," § 797.
	Right to dividends as between transferrer and transferee, § 798.
	As between life-tenant and remainderman, §§ 799-801.

§ 776. THE legal relations between individual shareholders and the majority acting as the body corporate, were discussed in Chapter IX. It remains in this chapter to consider the relations among individual shareholders acting for themselves and representing only their own rights and interests in the corporate enterprise.

§ 777. The legal relations between shareholders are of two classes, and may appropriately be treated under two general divisions. First, those which subsist between shareholders, as it were indirectly, by reason of the relationship sustained by them towards the body corporate; of which relationship the general result that works itself out into relations between the shareholders individually, is that each is entitled as against all others to share in the profits of the corporate enterprise in the proportion

borne by his shares to the total number, and has the further right, that each shall bear a proportionate share of whatever liability may arise out of the corporate enterprise. Secondly, those legal relations which subsist directly between the successive holders of the same shares of stock, or between persons possessing rights in the same shares: legal relations which have no reference to the rest of the shareholders, and do not depend primarily on a relationship sustained towards the corporation.

§ 778. The rights and liabilities constituting the legal relations of the first class are as a usual thing enforceable by individual shareholders against each other only after some default or failure to act on the part of the corporate management, or else they come into play only on the insolvency of the corporation. But with legal relations of the second class, the corporate management has little or nothing to do. An instance of the first class is the right which each shareholder has that no other shareholder shall be released from his liabilities as such in a manner unauthorized by the corporation constitution. Instances of the second class appear in the right of the vendor or vendee of shares to have the other take the necessary steps to complete the transfer; or in the rights which subsist between a person having the life interest in certain shares and the remainder-man.

§ 779. It is the right of shareholders that every one of their number shall pay over to the corporate management a value in cash or property equal to the par value of the shares subscribed for by him.¹ Consequently, every agreement between a subscriber and the corporate agents by which the former is not to pay the face of his subscription, is fraudulent and void as to shareholders not consenting.² Thus, a separate agreement made

Rights of shareholders that each shall bear his proportion of the corporate burdens.

¹ See § 545.

² *White Mountains, etc. R. R. Co. v. Eastman*, 34 N. H. 124; *Graff v. Pittsburgh, etc. R. R. Co.*, 31 Pa. St. 489; *Robinson v. Pittsburgh, etc. R. Co.*, 32 Pa. St. 334; *Miller v. Hanover Junction, etc. R. R. Co.*, 87 Pa. St. 95; *Connecticut, etc. Rivers R. R. Co. v. Bailey*, 24 Vt. 465, 476; *Jewett v. Valley R'y Co.*, 34 Ohio St., 601, 609. See *Bailey v. Pittsburgh, etc. Gas-coal Co.*, 69 Pa. St. 334; *Wood v. Pearce*, 2 Disney (Ohio), 411. Compare *Buford v. Keokuk Northern Line Packet Co.*, 69 Mo. 611.

on subscribing for shares, whereby the subscriber on surrendering his certificate of stock is to receive back the part of his subscription already paid, and to be released from further payments, is a fraud on other shareholders: and when on the insolvency of the corporation, the receiver is enforcing subscriptions for the benefit of creditors, and is not including as shareholders the fraudulent subscribers, any shareholder may bring a bill for himself and others who may join, to compel such subscribers to assume their liabilities as shareholders.¹

§ 780. Likewise is it as essentially a right of shareholders as of creditors that no shareholder shall withdraw or be released from any liability arising out of the corporate enterprise, except in accordance with the constitution of the corporation;² and, except in accordance with that constitution, it is beyond the powers of the body corporate to release any of their number.³ But it would seem that a shareholder whom the body corporate had voted to release, might, under some circumstances, have the right to be indemnified by those who voted to release him from any liability in respect of

¹ *Melvin v. Lamar Ins. Co.*, 80 Ill. 446.

² *Spackman v. Evans*, L. R. 3 H. L. 171; *Dixon's Case*, L. R. 5 Ch. 79; *Gill v. Balis*, 72 Mo. 424; *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29. See *Houldsworth v. Evans*, L. R. 3 H. L. 263; *Miller v. Hanover Junction R. R. Co.*, 87 Pa. St. 95.

A decree is objectionable which confers on the receiver discretionary powers to compromise with shareholders; for each shareholder has a vested right in the subscription contract of every other shareholder; and it is beyond the power of a court of equity to invest any one with a discretionary right to release it. At least this cannot be done by a decree to which all the shareholders are not parties. *Chandler v. Brown*, 77 Ill. 333.

³ An arrangement allowing members

of a company to retire under certain conditions agreed to by a public meeting of the shareholders, convened after due notice to all the shareholders, is not in itself valid unless made in accordance with the provisions of the deed of settlement; and if not assented to directly or indirectly, after due notice, by all the shareholders, it may be impeached by any one of them. But if the means of notice to all appear sufficient, so as to raise a clear presumption of knowledge and acquiescence, and the arrangement is left unimpeached for a great number of years, the shareholder who has been allowed to retire, and whose name has been removed from the lists of the company, will be held to be relieved from his liability as a shareholder. *Evans v. Smallcomb*, L. R. 3 H. L. 249. See §§ 549, 550.

the corporate enterprise.¹ A transfer of shares made to an irresponsible person when the corporation is insolvent, for the purpose of escaping liability, is a fraud on the other shareholders, who will have to contribute more if the transfer is held valid,² just as much as such a transfer would be a fraud on creditors.³

§ 781. If a person is induced by a fraud of the corporate agents, for which the corporation is responsible, to subscribe for shares, he may rescind his contract by acting promptly. But it would be unjust to allow him to withdraw to the injury of others who have subsequently subscribed for shares or contracted with the corporation on the faith of his subscription. "It would be extremely difficult to maintain, upon general principles of law, that a private fraud between the original subscribers and commissioners, could be permitted to be set up, to the injury of subsequent purchasers, who become *bona fide* holders, without any participation or notice of the fraud."⁴

Subscriptions induced by fraud.

§ 782. Just as it is beyond the powers of the body corporate to release any shareholder from liability attaching to him under the constitution of the corporation, so it is also beyond the powers of the majority to increase the liability of shareholders to creditors.⁵ And it would seem that a change in the corporate constitution, pro-

Changes in the corporate constitution.

¹ In pursuance of a resolution passed at an extraordinary meeting of an unincorporated company, a shareholder sold his shares to the directors, upon the terms that he should withdraw from the company and be no longer liable for any of its debts. No power to enter into such an arrangement was contained in the deed of settlement. It was held that the shareholder was still liable for the debts of the company, and was properly included in the list of contributories. Lord Chancellor Cottenham, however, intimated that there might be equities between such shareholder and any shareholder who could be shown to have assented to the release. *Ex parte Morgan*, 1 Ha. &

Tw. 320. See *Zulueta's Claim*, L. R. 5 Ch. 444.

² See *Nathan v. Whitlock*, 9 Paige (N. Y.), 152; *Everhart v. Westchester, etc. R. R. Co.*, 28 Pa. St. 339; *Chouteau Spring Co. v. Harris*, 20 Mo. 382, 390; *Johnson v. Laffin*, 6 Cent. L. J. 131; S. C., 5 Dill. 76; *Angell and Ames on Corp.*, § 535.

³ See § 749.

⁴ *Minor v. Mechanics' Bank*, 1 Pet. 46, 66, opinion of the court per Story, J. See §§ 523-525. The English cases, however, are not in accord with this view. See *Smith's Case*, L. R. 2 Ch. 604.

⁵ *Trustees v. Flint*, 13 Metc. (Mass.) 539. See § 583.

cured by a majority from the legislature, would release a dissenting shareholder from his obligation to pay calls, at least so far as regards the rights of the members comprising the majority which procured the change.¹

§ 783. When the condition of the corporate affairs is such that liability to creditors for unpaid subscriptions arises, or where shareholders are affected with a statutory liability, either several or joint and several, and one shareholder is compelled to pay a debt of the corporation, he is in all cases entitled to contribution from the other shareholders, to an extent that will equalize among them all in proportion to the amount of stock held by them respectively, the corporate burdens.² "The right of contribution grows out of the organic relation among the stockholders. As between them and the creditors, each stockholder is severally liable [if the statute so declare him] to all the creditors; as between themselves, each stockholder is bound to pay in proportion to his stock."³

It has been held, however, that one shareholder who has paid a debt of the corporation, is not entitled to contribution from the other shareholders, until he has exhausted the property of the corporation that is bound to reimburse him.⁴ And if the liability on which the shareholder has been held to a creditor is statutory and the statute provides a remedy whereby share-

¹ See *Hartford and N. H. R. Co. v. Croswell*, 5 Hill, 388; §§ 530 *et seq.*

² *Aspinwall v. Torrance*, 1 Lans. (N. Y.) 381; *Brinham v. Wellersburg Coal Co.*, 47 Pa. St. 43; *Weber v. Fickey*, 47 Md. 196. See *Matthews v. Albert*, 24 Md. 527; *Masters v. Rossie Lead M'g Co.*, 2 Sandf. Ch. (N. Y.) 301; *Hadley v. Russell*, 40 N. H. 109; *Erickson v. Nesmith*, 46 N. H. 371; *Wincock v. Turpin*, 96 Ill. 135.

Where a corporation is not fully organized, so that, under the Missouri law (see *Hart v. Salisbury*, 55 Mo. 310; § 739), the shareholders remain

personally liable for the corporate debts, and certain shareholders pay those debts, they are entitled to contribution, even from those who have paid up their stock. *Richardson v. Pitts*, 71 Mo. 128. If the mode of obtaining contribution be prescribed by statute, it should be followed. *Brinham v. Wellersburg Coal Co.*, 47 Pa. St. 43.

³ *Umstead v. Buskirk*, 17 Ohio St. 113, 118, per White, J.

⁴ *Gray v. Coffin*, 9 Cush. 192. But in this case the plaintiff held for his security a mortgage on the corporate property, which he had not enforced.

holders shall obtain contribution from each other, the statutory remedy must be followed.¹ There is no implied promise on the part of shareholders to indemnify others, who, at the request of the former, became sureties for the corporation.²

§ 784. The relations among shareholders may be complicated by a shareholder being also a creditor of the corporation. In such case those rights and liabilities of the person holding such double status which appertain to him as shareholder must be regarded as distinct from the rights which belong to him as creditor. Ordinarily such a person can bring no action to enforce his rights as creditor in a form that will render it impracticable to discriminate between the two positions held by him; nor can an action by such a person suing as creditor be maintained in a court which has not the capacity to adjust his rights and liabilities.³

Where shareholders are also creditors.

§ 785. In an honestly conducted corporation the interests of all shareholders will for the most part coincide, unless there are different classes of shareholders. A separation of shareholders into classes with somewhat divergent interests may be occasioned by the issue of preferred shares, or might possibly arise from the fact that part of the shareholders own fully paid-up shares, while the shares of others are not fully paid up.

Classes of shareholders.

§ 786. Preferred shares are usually issued to obtain further capital for the prosecution of the corporate enterprise; and the rights of the holders as against the holders of common shares depend on the terms of the issue of the preferred shares.⁴ The usual provision included in those terms, the one, in fact, which constitutes shares preferred shares, is that the holders shall receive from the profits of the corporate business a certain amount of dividends before the holders of common stock shall receive anything.⁵ On

Rights of preferred shareholders.

¹ *O'Reilly v. Bard*, 105 Pa. St. & Cres. 419. Compare *Schaeffer v. 569; Brinham v. Wellersburg Coal Phoenix Brewery Co.*, 4 Mo. App. Co., 47 Pa. St. 43. 115. See § 733.

² *Larson v. Dayton*, 52 Iowa, 597.

³ See *Thayer v. Union Tool Co.*, 4 Gray, 75; *Bailey v. Bancker*, 3 Hill (N. Y.), 188; *Smith v. Huckabee*, 53 Ala. 191; *Milburn v. Codd*, 7 Barn.

⁴ For the power of a corporation to issue preferred shares, see §§ 571, 572.

⁵ "Unless there is some agreement or enactment to the contrary, preference shareholders are entitled to be

the other hand, preferred shareholders are not creditors of the corporation, and, in the absence of express provision, are entitled on the winding up of the business to receive the principal of their shares only in the same proportion with the holders of common stock.¹

It is apparent how the interests of preferred shareholders may differ from those of the holders of common shares. For instance, one course of policy may insure for the corporation sufficient profits to pay the dividends on the preferred stock; while another course, proper but more hazardous, will probably result in profit sufficient to pay dividends on all the stock, common as well as preferred. Evidently it will be for the interests of the preferred shareholders to have the corporation pursue the former course.

§ 787. Again, a divergence of interest might arise from the fact that some shares in the corporate stock are fully paid up, while others are not. When there is no special provision regulating the matter, it would seem in such case that any dividends earned should be distributed among the shareholders, not in proportion to the nominal amount of stock held by them, but according to the amounts of capital they have actually paid in.² But, however this may be, undoubtedly on the winding up of the company and the distribution of its assets, each shareholder is entitled to

paid out of the profits of the company their dividends to the amount guaranteed, before the other shareholders receive anything; so that if the profits divisible at any given time are not sufficient to pay the guaranteed dividends in full, the deficiency must be made good out of the next divisible profits; the ordinary shareholders taking no profits until all arrears of guaranteed dividends have been paid to the preference shareholders." 2 Lindley on Part., 796; acc. Boardman v. Lake Shore, etc. Ry. Co., 84 N. Y. 157. See § 564.

¹ *In re* London India Rubber Co.,

L. R. 5 Eq. 519; *McGregor v. Home Ins. Co.*, 33 N. J. Eq. 181.

² Still this is by no means clear. "Where there are several classes of shares on which unequal sums have been paid up, the profits of the company ought *prima facie* to be divided amongst the shareholders in proportion to the sums paid up on their respective shares, and not in proportion to the nominal values of such shares." 2 Lindley on Part., 797. See *Somes v. Currie*, 1 K. & J. 605; *In re* Hodges Distillery Co., *Ex parte* Maude, L. R., 6 Ch. 51.

receive in proportion to the amount which he has actually contributed for corporate purposes.¹

§ 788. Aside from considerations arising from the circumstance that part of the shares are preferred, or that a part are more fully paid up than others, every shareholder is entitled, both in the distribution of profits and on the winding up of the corporation, to participate in proportion to the number of shares held by him. Equal rights of shareholders. "*Prima facie* all stockholders at any particular period are equally interested in the property and business of a corporation. They assume the same liabilities, are entitled to the same rights, and are equal owners of the property. When, therefore, the directors undertake to distribute among the stockholders any portion of the funds or property of a corporation, whether it be called profits or not, all stockholders are entitled to an equal share in the fund, proportionate to their stock; whether they have been stockholders for a longer or shorter period. Unless the charter give to the directors power to discriminate between stockholders at different periods in the distribution of profits, they are all entitled to share therein."² Accordingly, at the suit of a minority, a court will restrain the majority from appropriating to themselves the assets of the corporation, or from obtaining advantages not shared in by the minority.³ Agreements, however, entered into by a group of shareholders who hold a majority of stock, whereby they agree to act together in influencing the corporate management, may be upheld so long as the interests of the other shareholders are not fraudulently or unfairly sacrificed; and even then will not be set aside at the instance of the parties to them, but only

¹ *Hartman v. Insurance Co.*, 32 Gratt. (Va.) 242. In proportion to his "in-put," as it is expressed in this case.

² *Jones v. Terre Haute, etc. R. R. Co.*, 29 Barb. 353, 357, per Ingraham, J.; S. C., aff'd, 57 N. Y. 196. Acc. *Jackson's Admr's v. Newark Plank Road Co.*, 31 N. J. L. 277.

³ *Menier v. Hooper's Telegraph Works*, L. R. 9 Ch. 350. See §§ 558,

559. Compare *Bailey v. Citizens' Gas Light Co.*, 27 N. J. Eq. 196.

Certain parties fraudulently representing that the entire assets of a corporation belonged to them, procured a decree of a court dissolving the corporation, and acquired possession of its assets. They were held as trustees *ex maleficio* for *bona fide* shareholders. *Bailey's Appeals*, 96 Pa. St. 253.

on complaint of some innocent shareholder whose interests are injured.¹

§ 789. Coming now to the second class of legal relations between shareholders, it may be remarked that many of the rules regulating the sale of personal property apply to the relations between the transferrer and transferee of shares.² The transferee of a certificate of stock occupies the position of the assignee of a chose in action which for most purposes is negotiable.³ A reciprocal agreement to transfer and accept a transfer of shares is not a *nudum pactum*; but the mutual promises constitute good considerations for each other: and this, although nothing has been paid on the shares.⁴

§ 790. Further, a contract for the sale of shares will be specifically enforced in equity, if it is not unconscionable⁵ or against public policy, when from the scarcity of the shares or other reasons the purchaser cannot go into the market and purchase similar ones.⁶ But if shares

¹ *Faulds v. Yates*, 57 Ill. 416. Compare *Foll's Appeal*, 91 Pa. St. 434; *post*, § 790. But see *Woodruff v. Wentworth*, 133 Mass. 309; *Guernsey v. Cood*, 120 Mass. 501; § 577, note.

² A person may sue another for the conversion of shares of stock. *Kuhn v. McAllister*, 1 Utah, 273; *Nabring v. Bank of Mobile*, 58 Ala. 204. Compare *Reid v. Commercial Ins. Co.*, 32 La. Ann. 546. In England a contract for the sale of shares is held not to be a contract for the sale of goods, wares, or merchandise, within the statute of frauds. *Duncuft v. Albrecht*, 12 Simons, 189. But in America the reverse is the law. *Tisdale v. Harris*, 20 Pick. (Mass.) 9; *Baltzen v. Nicolay*, 53 N. Y. 467; *North v. Forest*, 15 Conn. 400; *Pray v. Mitchell*, 60 Me. 430; *Colvin v. Williams*, 3 H. & J. (Md.) 38.

³ Stock may however be held by a

valid title, without a certificate, which is but *indicia* of title, and the right to the stock is in the nature of a non-negotiable chose in action. Accordingly, stock certificates issued by order of a Confederate court, after confiscation of the shares of "alien enemies," are void, and no better in the hands of a transferee than in those of the original holder, as against the rightful owner of the stock. *Dewing v. Perdicaries*, 96 U. S. 193.

⁴ *Cheale v. Kenward*, 3 De G. & J. 27. A memorandum of a contract to purchase shares signed by the purchaser, is an admission of the existence of the corporation. *Mann v. Williams*, 143 Mass. 394.

⁵ See *Mississippi and M. R. R. Co. v. Cromwell*, 91 U. S. 643.

⁶ *Johnson v. Brooks*, 93 N. Y. 337; *White v. Schuyler*, 1 Abb. Pr. N. S. (N. Y.) 300; S. C., 31 How. Pr. (N. Y.) 38; *Todd v. Taft*, 7 Allen, 371;

similar to those which are the subject of the sale, are readily purchasable in the market, equity will not, as a general rule, specifically enforce the contract; but will leave the parties to their remedies at law.¹ And equity will pursue a similar course when for any reason the contract for the sale of the shares is against public policy. Thus it has been decided in Pennsylvania that, for reasons of public policy, equity will not decree the specific performance of a contract to sell shares in the stock of a national bank, the object of the purchase being to obtain the control of the bank.² "While the legal right of the complainant to buy up sufficient of the stock of this bank to control it in the interest of himself and his friends may be conceded, it is by no means clear that a court of equity will lend its aid to help him. A national bank is a *quasi* public institution. . . . Were we to affirm this decree, I see no reason why we may not be called upon to use the extraordinary powers of a court of equity to assist in miscellaneous stock jobbing operations."³

If the transfer of shares forms part of a contract that equity will specifically enforce, as, for instance, a contract for the sale of land, equity will specifically enforce the transfer in the course of enforcing the main contract.⁴ On the other hand, if the contract to transfer shares is part of a contract which equity can-

Cheale *v.* Kenward, 3 De G. & J. 27; Duncuft *v.* Albrecht, 12 Simons, 189. Compare Chater *v.* San Francisco Sugar Refining Co., 19 Cal. 219; Cushman *v.* Thayer M'fg Co., 76 N. Y. 368. Especially will equity specifically enforce a transfer in the course of enforcing a trust. Coles *v.* Whitman, 10 Conn. 121; Draper *v.* Stone, 71 Me. 175. Compare Wonson *v.* Fenno, 129 Mass. 405; Colquhoun *v.* Courtenay, 43 L. J. Eq. 338; Johnson *v.* Brooks, *supra*.

¹ Ross *v.* Union Pac. Ry. Co., 1 Woolw. 26. But see Ashe *v.* Johnson, 2 Jones Eq. (N. C.) 149. Like-

wise the specific transfer or delivery of particular shares, rather than others, will not be enforced; all being alike. Hardenbergh *v.* Bacon, 33 Cal. 356; Hubbell *v.* Drexel (U. S. Cir. Ct. Eastern Dist. of Pa.), 21 Am. Law Reg. (N. S.) 452. See § 794.

² Foll's Appeal, 91 Pa. St. 434. Compare Faulds *v.* Yates, 57 Ill. 416; § 788.

³ Foll's Appeal, 91 Pa. St. 434, 437. Opinion of the court per Paxson, J.

⁴ Leach *v.* Fobes, 11 Gray, 506; Bissell *v.* Farmers', etc. Bank, 5 McLean, 495.

not or will not specifically enforce, the transfer of shares will not be enforced specifically.¹

§ 791. The purchaser is not the only party to the contract who is entitled to its specific performance. When any liability is connected with the shares, either for unpaid subscriptions or on account of some statute creating individual liability on the part of shareholders, the vendor has the right to have the vendee specifically perform the contract, and register himself as owner of the shares, in order that the vendor may be freed from liability.² And at all events after a valid sale has been made, the vendee is bound to indemnify the vendor from all liability as to future calls,³ as well as from liability created by statute.⁴

§ 792. If the transferrer is guilty of such misrepresentations or concealments as would entitle the purchaser of personal property to have a sale set aside, the transferee will be discharged from his agreement to purchase,⁵ or he may hold to his bargain and sue the transferrer for damages.⁶

¹ *Ross v. Union Pac. R'y Co.*, 1 Woolw. 26; *Danforth v. Philadelphia and C. M. R'y Co.*, 30 N. J. Eq. 12; *Fallon v. Railroad Co.*, 1 Dill. 121.

² *Paine v. Hutchinson*, L. R. 3 Eq. 257; S. C., aff'd, L. R. 3 Ch. 388; *Shepherd v. Gillespie*, L. R. 5 Eq. 293; *Walker v. Bartlett*, 2 Jur. N. S. 643; S. C., 18 C. B. 845.

³ *Hutzler v. Lord*, 64 Md. 534; *Shepherd v. Gillespie*, *supra*; *Walker v. Bartlett*, *supra*; *Wynne v. Price*, 3 De G. & Sm. 310; *Cruse v. Paine*, 37 L. J. Eq. 711; *Evans v. Wood*, ib. 159; *Hodgkinson v. Kelly*, ib. 837; *Hawkins v. Maltby*, L. R. 4 Ch. 200; *Castellan v. Hobson*, L. R. 10 Eq. 47. Contra and *semble* overruled by above cases. *Humble v. Langston*, 7 M. & W. 517.

⁴ *Wheeler v. Faurot*, 37 Ohio St. 26; *Brown v. Hitchcock*, 36 Ohio St. 667. These were instances of liability

created by statute which was held to attach to shareholders who were such at the time when the debt was contracted by the corporation. See §§ 718 *et seq.*

⁵ See *Fosdick v. Sturges*, 1 Biss. 255. If, however, the transferee's name is registered as a shareholder, the rights of creditors or other shareholders might intervene.

⁶ *Riggs v. Tayloe*, 2 Cranch Cir. Ct. 687. A person who agrees to purchase shares of a shareholder at a future date certain cannot plead, that before that date the company mortgaged its road or consolidated with another, in pursuance of powers contained in its charter. *Noyes v. Spaulding*, 27 Vt. 420. A transfer of shares fraudulently procured from the owner when drunk may be set aside. *Thackrah v. Haas*, 119 U. S. 499.

§ 793. A party selling as his own personal property of which he is in possession, impliedly warrants his title to the thing sold. This doctrine applies to the sale of such choses in action as shares of stock. The certificate is the evidence of ownership, and if the certificate is forged, or the holder is not a *bona fide* holder, and from the circumstances transfers no valid claim as against the corporation, he will be liable to his vendee on this implied warranty of title. For his possession of the certificate is as to the vendee possession of the stock. But when the holder is such in good faith, and the certificate is in the usual form, regular on its face, sealed with the genuine corporate seal, and issued by the duly constituted officers of the corporation, the vendor's warranty does not cover the case, but the vendee, if there is anything wrong with the stock, has a remedy for damages against the corporation.¹

Warranty
by trans-
ferrer.

§ 794. It has been held that in cases of pledge the pledgee must be put into possession of the thing pledged, or if that be a claim the evidence of the obligation must be delivered, and, accordingly, that shares cannot be pledged unless they are evidenced by certificates, which must be delivered to the pledgee.² In the absence of specific agreement to the contrary, the pledgee of shares is entitled to have them transferred to his own name on the books of the company, and when such transfer is made, he is not bound to retain the identical shares pledged, provided he keep on hand a number of similar shares sufficient to answer the pledgor's demand on repayment of the loan.³ It is held, moreover, that a pledgor

Pledge of
shares.

¹ *People's Bank v. Kurtz*, 99 Pa. St. 344. See §§ 592 *et seq.* The transferrer of shares does not impliedly warrant the corporation's title to its property, nor is there any implied warranty to that effect when the corporation is itself the nominal transferrer, if it is only the medium through which its then shareholders transfer their shares to the transferee. *State of Louisiana v. North Louisiana and T. R. R. Co.*, 34 La. Ann. 947.

364. Compare *Cherry v. Frost*, 7 Lea (Tenn.), 1.

² *Hubbell v. Drexel* (Cir. Ct. Eastern Dist. of Pa.), 21 Am. Law Reg. N. S. 452; *Nourse v. Prime*, 4 Johns. Ch. (N. Y.) 490; *Allen v. Dykers*, 3 Hill (N. Y.), 593; *Gilpin v. Howell*, 5 Pa. St. 41; *Neiler v. Kelley*, 69 Pa. St. 409; *Boylan v. Huguet*, 8 Nev. 345; see *Otis v. Gardner*, 105 Ill. 436. See *Hayward v. Rogers*, 62 Cal. 348; *Barclay v. Culver*, 30 Hun (N. Y.), 1. Compare *Langton v. Waite*,

of shares is not entitled to an injunction restraining the pledgee, to whose name the shares have been transferred on the books, from voting on them, at least not if the complaint contain only allegations to the effect that the pledgee is voting the shares so as to subserve the interests of another corporation, and that it is greatly against the pledgor's interest to allow the pledgee to vote them.¹

§ 795. Certificates of stock, even those bearing on their face such a phrase as "transferable only on the books of the company," are for most purposes negotiable. By an assignment of the certificate the legal title to the stock passes;² and the possession of the certificate properly indorsed is *prima facie* evidence of ownership. Consequently, the assignee for value without notice of prior equities, obtains a title superior to them; and if the rightful owner has invested another with the usual evidence of title or with apparent authority to dispose of the shares, he will be estopped from disputing the rights of an innocent purchaser.³ And the doctrine of the implied notice of *lis pendens* has no application to certificates of stock which pass from hand to hand like nego-

L. R. 6 Eq. 165; *Cherry v. Frost*, 7 Lea (Tenn.), 1. A pledgee of shares, that have been transferred on the books of the corporation, cannot sell them without notice to the pledgor and demand of payment; nor at private sale, for less than market value. *Nabring v. Bank of Mobile*, 58 Ala. 204. And an agreement that pledgee may sell without notice, does not permit him to sell without demand of payment. *Wilson v. Little*, 2 N. Y. 443.

An execution cannot be levied on shares of stock pledged by the execution debtor and transferred on the books of the corporation to the pledgee. A purchaser at such execution sale gets no title. *Nabring v. Bank of Mobile*, 58 Ala. 204.

¹ *McHenry v. Jewett*, 90 N. Y. 58.

The court did not decide who was entitled to vote the shares, but merely that the complaint was bare of facts justifying an injunction. See § 578.

² *Leitch v. Wells*, 48 N. Y. 585.

The tender of a certificate properly indorsed is a good tender of shares "transferable on the books of the company." *Noyes v. Spaulding*, 27 Vt. 420.

³ *Walker v. Detroit R'y Co.*, 47 Mich. 338; *McNeil v. Tenth Nat. B'k*, 46 N. Y. 325; *Cherry v. Frost*, 7 Lea (Tenn.), 1; *Dovey's Appeal*, 97 Pa. St. 153; *Gass v. Hampton*, 16 Nev. 185; *Stinson v. Thornton*, 56 Ga. 377; *Otis v. Gardner*, 105 Ill. 436. See *Winter v. Belmont M'g Co.*, 53 Cal. 428; *Caulkins v. Gaslight Co.*, 85 Tenn. 683.

tible instruments.¹ But a *bona fide* purchaser of a stolen certificate acquires no title as against the true owner.²

§ 796. Likewise, although it be provided that all transfers of shares shall be recorded on the books of the corporation, and the certificates state that shares are transferable only in that manner, a *bona fide* sale of the shares, or an assignment of them as collateral security, accompanied by a delivery of the certificates with a power of attorney, is valid as against the attaching creditors of the vendor or assignor,³ and also as against his assignee in insolvency.⁴ But it has been held, where a statute provides that no assignment of stock shall be valid except as between the parties until it is entered on the books of the corporation, that an attachment by the assignor's creditors, levied before such entry, is valid as against the assignee of the certificate.⁵ And, in

As against
assignor's
creditors.

¹ Leitch v. Wells, 48 N. Y. 585; Holbrook v. New Jersey Zinc Co., 57 N. Y. 616.

² Barstow v. Savage M'g Co., 64 Cal. 388.

³ Scott v. Pequonnock Nat. Bank, 15 Fed. Rep. 494; Smith v. Crescent City Live Stock, etc. Co., 30 La. Ann. Part. II. 1378; Cornick v. Richards, 3 Lea (Tenn.), 1; Broadway Bank v. McElrath, 13 N. J. Eq. 24; Colt v. Ives, 31 Conn. 25; Beckwith v. Burrough, 13 R. I. 294; Merchants' Nat. B'k v. Richards, 6 Mo. App. 454; S. C., aff'd 74 Mo. 77; Newberry v. Detroit, etc. Iron M'f'g Co., 17 Mich. 141; Sargent v. Essex Marine R'y Co., 9 Pick. 202. See Sargent v. Franklin Ins. Co., 8 Pick. 90; Clark v. German Security Bank, 61 Miss. 611; Seeligson v. Brown, 61 Tex. 114. But compare State Ins. Co. v. Sax, 2 Tenn. Ch. 507. But such an assignment of the certificates would not hold as against a *bona fide* purchaser who is not an execution creditor of the assignor, at sheriff's sale under an exe-

cution. Farmers' Nat. B'k v. Wilson, 58 Cal. 600. Compare Newberry v. Detroit, etc. Iron M'f'g Co., 17 Mich. 141; Weston v. Bear River M'g Co., 6 Cal. 425. See § 589. But transfers of shares made with intent to hinder and defraud creditors are void. Beckwith v. Burrough, 14 R. I. 366.

⁴ Sibley v. Quinsigamond Nat. B'k, 133 Mass. 515; Blouin v. Liquidators of Hart, 30 La. Ann. Part. I. 714. The equitable interest of a shareholder in his shares will pass by a general assignment in a trust deed for the benefit of creditors, as against an attaching creditor with notice of the assignment, although the charter of the corporation provides that transfers to be valid must be entered on the books. Black v. Zacharie, 3 How. 483.

⁵ Application of Murphy, 51 Wis. 519. See also Newell v. Williston, 138 Mass. 240; Central National Bank v. Williston, 138 Mass. 244; Fisher v. Essex Bank, 5 Gray, 373; Boyd v. Rockport Steam Cotton Mills, 7 Gray, 406; Blanchard v. Dedham Gaslight

general, shares of stock are subject to attachment, and an attaching creditor acquires a lien superior to the claim of a subsequent *bona fide* purchaser for value with no actual notice of the attachment.¹

§ 797. The preceding rules protecting the assignee of certificates of stock, are not applicable when the certificate bears on its face a notice that its holder is not the absolute owner. Thus, a person lending money on a certificate containing the words "in trust," is affected with notice of the trust, and the hypothecation will be invalid as against the *cestui*.² And a similar rule would apply if the assignee of the certificate has or is affected with notice of the rights of persons other than the holder. Thus, it has been held, that a person purchasing shares from an administrator at an illegal private sale, will be liable to the distributees of the estate for dividends received by him.³

§ 798. Individual shareholders have no right to profits made by the corporation until a dividend is declared. Accordingly, a dividend belongs to the owner of the shares at the time when it is declared, whether it was earned before he acquired the shares or subsequently.⁴ And a sale of shares after a dividend has been

Co., 12 Gray, 213; *Weston v. Bear River, etc. Water and M'g Co.*, 5 Cal. 186; *Naglee v. Pacific Wharf Co.*, 20 Cal. 529. But compare *Weston v. Bear River M'g Co.*, 6 Cal. 425.

¹ *Chesapeake and Ohio R. R. Co. v. Paine*, 29 Gratt. (Va.) 502; *Shenandoah Valley R. R. Co. v. Griffith*, 76 Va. 913. So the interest of a shareholder in the property of a corporation, represented by shares of stock, may be reached by garnishee process served on the corporation. The corporation may be the attaching creditor and garnishee itself. *Norton v. Norton*, 43 O. St. 509 (a case construing statutes).

² *Shaw v. Spencer*, 100 Mass. 382; *Loring v. Brodie*, 134 Mass. 453;

Budd v. Monroe, 18 Hun, 316; *Gaston v. American Exchange Nat. B'k*, 29 N. J. Eq. 98. But see *semble*, contra, *Brewster v. Sime*, 42 Cal. 139; *Winter v. Belmont M'g Co.*, 53 Cal. 428.

³ *Nutting v. Thomasson*, 57 Ga. 418.

⁴ *Jermain v. Lake Shore, etc. R'y Co.*, 91 N. Y. 483; *Boardman v. Lake Shore, etc. R'y Co.*, 84 N. Y. 157; *Brundage v. Brundage*, 65 Barb. 397. See *Hyatt v. Allen*, 56 N. Y. 553; *March v. Eastern R. R. Co.*, 43 N. H. 515. A bequest of shares does not carry a scrip dividend received by the testator during his life; but such a dividend declared after testator's death, belongs to the legatee. *Brundage v. Brundage*, *supra*.

When preferred or guaranteed divi-

declared, does not carry the dividend, although it is not payable until after the sale.¹ Similarly it is held, where the directors "vote to pay a dividend of four per cent. this day, and another of like amount from earnings of last year," that the person who owns the shares when the dividends are thus voted is entitled to both dividends although he sell the shares before the day for the payment of the second dividend has been fixed.²

§ 799. Difficult and still unsettled questions respecting the ownership of dividends, arise when the shares are left in trust by will, the income of the trust to go to a life-tenant, and the principal, at his death, to a remainder-man. There is little doubt that a reasonable amount of profit, earned before the testator's death, but declared in the shape of an ordinary cash dividend after that event, is income and belongs to the life-tenant.³ But an ordinary cash dividend earned before, but declared after the testator's death is to be distinguished from a distribution in the shape of a cash dividend—consequent, perhaps, on a change of policy in the body corporate—of long accumulated profits. "Where the profits of a corporation have been accumulating for many years, till the market value of the stock is double its original price, and the owner dies, directing the 'income' of his estate to be applied to particular objects for limited periods, these extraordinary accumulations are as much a part of his capital as any other portion of his estate, and must therefore be

As between life-tenant and remainder-man.

dends *should* have been paid at a certain time, but were not declared, and the shareholder entitled to them did not enforce their declaration, they remain payable to the holder of the stock, and pass with a transfer of it. *Jermain v. Lake Shore, etc. R'y Co.*, 91 N. Y. 483; *Manning v. Quicksilver M'g Co.*, 24 Hun, 361.

¹ *Bright v. Lord*, 51 Ind. 272; *Spear v. Hart*, 3 Rob. (N. Y.) 420. *Contra (semble)*, *Burroughs v. North Carolina R. R. Co.*, 67 N. C. 376.

A shareholder is not liable for divi-

dends received by him, in the first instance, to a person claiming to be the owner of the stock, but whose claim the company ignores. Such a person must first establish his claim against the company. *Peckham v. Van Wagenen*, 83 N. Y. 40. This proposition might be affected, however, by relations between the plaintiff and defendant.

² *Hill v. Newichawanick Co.*, 8 Hun, 459, *aff'd* 71 N. Y. 593.

³ *Bates v. Mackinley*, 31 Beav. 280; *Millen v. Guerrard*, 67 Ga. 284.

regarded as forming part of the principal from which the future income is to arise."¹

Likewise, when after the testator's death, the corporation sells a portion of its property or franchises, and distributes the proceeds in the shape of a cash dividend, that too is a part of the principal, and is not income to be paid over to the life-tenant.² Of a similar status is money paid to a corporation for property taken by a city, and distributed as a cash dividend.³ But moneys arising from the sale of corporate property and distributed as a cash dividend, are income if they arise from a sale of property made by the corporation in the ordinary course of its business, when it sells only such property as its regular business is to sell.⁴

§ 800. In regard to the status of dividends not payable in cash, the authorities are more conflicting. The rule has indeed been stated in Massachusetts, that cash dividends are income and stock dividends are principal.⁵ But, even according to the Massachusetts decisions, that which may be distributed in the form of a cash dividend is sometimes principal;⁶ and in New York, stock dividends declared out of earnings are held to be income.⁷ It has also been held where a testator directed the

¹ Earp's Appeal, 28 Pa. St. 368, 375, opinion of the court per Lewis, C. J. But all profit arising after the death of the testator is "income," Wiltbank's Appeal, 64 Pa. St. 256; Biddle's Appeal, 99 Pa. St. 278, 282; Earp's Appeal, 28 Pa. St. 368; Van Doren v. Olden, 19 N. J. Eq. 176. See Moss's Appeal, 83 Pa. St. 264. Compare, *In re Bouch*, 29 Ch. Div. 635. This distinction is discarded in *Richardson v. Richardson*, 75 Me. 570, where the rule is stated to be, that all cash dividends, declared from profits, go to the person holding the stock at the time (*i. e.*, the life-tenant), without regard to the time when the profits were earned or their source, and regardless of the size of the dividend;

provided it is not a distribution of the company's assets, as on winding-up.

² Vinton's Appeal, 99 Pa. St. 434; *Wheeler v. Perry*, 18 N. H. 307; *Gifford v. Thompson*, 115 Mass. 478. See *Clarkson v. Clarkson*, 18 Barb. 646. But see *Balch v. Hallet*, 10 Gray, 402.

³ *Heard v. Eldridge*, 109 Mass. 258.

⁴ *Reed v. Head*, 6 Allen, 174.

⁵ *Minot v. Paine*, 99 Mass. 101. See *Leland v. Hayden*, 102 Mass. 542; *Daland v. Williams*, 101 Mass. 571; *In re Hopkins's Trusts*, L. R. 18 Eq. 696. And see *Richardson v. Richardson*, 75 Me. 570, 574.

⁶ *Heard v. Eldredge*, *supra*.

⁷ *Simpson v. Moore*, 30 Barb. 637; *Riggs v. Cragg*, 26 Hun, 89; *Goldsmith v. Swift*, 25 Hun, 201.

income of shares to be paid to one person for life, remainder to other parties, that dividends declared in the form of certificates of indebtedness go to the life-tenant, although they may consist in part of profits accumulated before the testator's death.¹ But where it is resolved to increase the corporate stock, and the right of shareholders to subscribe is valuable, and is sold, the proceeds are principal of which the interest only goes to the life-tenant.²

§ 801. In regard to this somewhat confusing matter of the rights of life-tenant and remainder-man in stock dividends, the following suggestions are hazarded. Usually to speak of a "stock dividend" involves in reality a contradiction in terms. A dividend is a distribution of profits. But when a corporation has accumulated profits, and declares a "stock dividend," just what the corporation does not do is to declare a dividend. A "stock dividend" is no dividend, no real distribution, either of profits or capital; but merely an increase in the number of shares into which the capital is divided.³ For instance, some years ago, when the stock of the Rock Island Railroad was selling at more than double its par value, the corporation issued to every shareholder an additional share for each share of stock already held by him. The object accomplished was the halving of the market value of the shares. But by this action no part of the capital or accumulated profits of the corporation was

¹ *Millen v. Guerrard*, 67 Ga. 284. The English cases seem to point to the rule that the intention of the corporation to declare a dividend as such governs. See *In re Bouch*, 29 Ch. Div. 635, 653; *Hooper v. Rossiter*, 1 McClel. 527; *Barclay v. Wainwright*, 14 Vesey, 66; *Price v. Anderson*, 15 Simons, 473; *Preston v. Melville*, 16 Simons, 163; *Johnson v. Johnson*, 15 Jur. 714.

² *Atkins v. Albree*, 12 Allen, 359; *Biddle's Appeal*, 99 Pa. St. 278; *Brinley v. Grou*, 50 Conn. 66.

³ "After a stock dividend a corporation has just as much property as it had before. It is just as solvent and

just as capable of meeting all demands upon it. After such a dividend the aggregate of the stockholders own no more interest in the corporation than before. The whole number of shares before the stock dividend represented the whole property of the corporation, and after the dividend they represent that and no more. A stock dividend does not distribute property, but simply dilutes the shares as they existed before." *Williams v. Western Union Tel. Co.*, 93 N. Y. 162, 189. See also *Gibbons v. Mahon*, 4 Mackay (Dist. of Col.), 130. And compare *Commonwealth v. Pittsburgh, etc. Ry. Co.*, 74 Pa. St. 83.

distributed among the shareholders. Take, for another instance, the present condition of the Chemical Bank of New York City. The par value of its shares, in number three thousand, is one hundred dollars; but their market value, at the present time, is about two thousand dollars. Should the Chemical Bank issue another share of stock to each shareholder for every share already held by him, it would not distribute one cent. Where, before such issue or "stock dividend," if one so choose to call it, the holder of one share owns one three-thousandth of the entire property, after such issue he will own two six-thousandths.¹

Consequently, since a "stock dividend" is no real dividend or distribution of profits, it would seem that even if such "dividend" were "declared out of profits," the stock so issued could not be regarded as income; for it must be conceded that the life-tenant has no right to claim corporate earnings as income of the trust created in his favor until the corporate management has voted to distribute them as a dividend; and if the corporate management decides on declaring a stock dividend, what it really decides on, is not to declare a dividend at all.²

¹ See *Terry v. Eagle Lock Co.*, 47 Conn. 141, 164; § 568, and *Williams v. Western Union Tel. Co.*, 93 N. Y. 162, 189, *supra*; also *Osborne v. Osborne*, 24 Grat. (Va.) 392. New shares representing the surplus property of a corporation are principal and not income. *Petition of Brown, Administrator*, 14 R. I. 371.

By noticing the rights of creditors, it will become still more apparent that a stock dividend is no dividend at all. As against creditors a corporation, which has no surplus earnings, has no right to declare a cash dividend, and in that way distribute its capital among the shareholders. But it might declare "stock dividends" *ad infinitum*, and no creditor be any the worse, or any shareholder have a cent more in his

pocket. To be sure, "stock dividends" may become very material in view of outside considerations; as where a corporation is restricted from paying more than a certain percentage of dividends. By issuing further stock it might (if the issue were not declared void) keep down the percentage of dividends, while it increased their amount. But, none the less, the issue of the stock would itself be no dividend.

² This rule might seem to work hardship on the life-tenant. But, if so, the real cause of his hardship is the action of the corporate management in not declaring a dividend; and possibly, in an extreme case, the life-tenant might compel the declaration of a dividend.

CHAPTER XVI.

LEGAL RELATIONS AMONG THE OFFICERS OF A CORPORATION.

Directors, § 802.

Contribution among directors; respecting liability to the corporation, §§ 803, 804.

Respecting liability to creditors, § 805.

Between directors bound on the same instrument, § 806.

Between directors and other officers, § 807.

Right of directors to inspect the corporate books, § 808.

De facto directors, § 809.

§ 802. DIRECTORS meet together, consult, and together transact the business of the corporation. But their mutual legal relations as directors are few, perhaps their most important right as against each other being that no one of their number shall commit any wrongful act through which the corporate interests are injured in a way that will implicate other directors in liability to make good the damages. Directors.

§ 803. The common rule of law that there is no contribution among tort-feasors¹ must be strictly construed in relation to directors and other officers and agents of corporations, for they may be held liable for the wrongful acts of each other in cases which are not within the contemplation of the rule. In two classes of cases the rule seems inapplicable. First, when directors are held liable for the acts of their appointees or associates;² and secondly, when by some statute directors are rendered liable, although guilty of no default, for the wrongful acts of each other or of other corporate agents.³ Accordingly, if directors Contribution among directors; respecting liability to the corporation.

¹ There seem to have been exceptions to this rule at common law, *e. g.*, where one of two persons was held liable for the tort of their common servant, contribution from the other was allowed. *Wooley v. Batte*,

2 Car. & P. 417. But see *Oakes v. Spalding*, 40 Vt. 347; and *Spalding v. Oakes*, 42 Vt. 343.

² See § 624.

³ See, *e. g.*, Const. of Cal., 1879, art. xii. § 3.

are, for any reason, held liable for the damages resulting from the wrongful acts or omissions of their appointees, or of other directors, when they themselves have neither participated in the wrongful acts nor connived at them, they would certainly seem to be entitled to indemnification from their appointees in the one case, and from the other directors in the other.

This notion of different degrees of liability for wrongful acts or omissions is by no means a new doctrine, nor altogether the result of statute. Lord Hardwicke said in *Charitable Corporation v. Sutton*:¹ "In the present case one thing is clear, that [those] who were the five engaged in that confederacy are certainly liable to make good the losses which the corporation have sustained in the first place, and the committee-men [directors] who were not partners in the affair, in the second place only." Lord Hardwicke had in his mind rather their degrees of liability as enforced in a suit brought by the corporation; still, carried out logically, any such idea must end in allowing contribution or indemnification among directors and other officers of a corporation.

§ 804. And decisions sustain this conclusion.² Thus, in an English case, it was held an irregularity for directors to take the promissory notes of one of their number, instead of cash, in payment for shares; and an irregularity that would render them liable to make good to the company any loss occurring on a promissory note so taken. But the court also held that the transaction was not so fraudulent or illegal as to entitle the representatives of the debtor to repudiate his debt as to the company; and that the directors, who had voluntarily made good the full price of the shares, were entitled to be indemnified out of the assets of the debtor.³ The court further held in another case, arising apparently from the same facts, that the directors who took part in the meetings at which the transactions were authorized, were entitled to contribution from each

¹ 2 Atkyns, 400, 404, § 619.

² When a director, by agreement with his co-directors, for whom he is to act as well as for himself in the matter, has taken bonds of the corporation below par, and sold them at a profit, and has been obliged to account

to the corporation for the whole amount of profit realized, he is entitled to contribution from such of his co-directors as were associated with him in the transaction. *Widrig v. Newport Street R'y Co.*, 82 Ky. 511.

³ *Power v. Hoey*, 19 W. R. 916.

other; and that they need not wait until sued by the company, or until a loss had certainly befallen it; but being themselves bound to make good the matter at once, they were at once entitled to contribution. The court said, moreover, that it would draw a line between those who participated, and those who were merely negligent in allowing the improper transactions.¹

A rule for such cases might perhaps be stated thus: If directors A., B., C., and D. are held liable for the wrongful act of director E., with which they were in no way concerned, either actively or by connivance, they will have the right as against E. to complete indemnification; and if one of their number, as for instance A., has been forced to pay all or more than his proportion of the loss arising from the wrongful act, he will be, as against B., C., and D., entitled to contribution.²

§ 805. Still, when the liability is the result of an act or an omission which may be imputed to each one of the directors, it has been held that no contribution among them would obtain. As in the case of *Andrews v.*

Respecting
liability to
creditors.

Murray,³ where it was held that no contribution could be had in respect of liability arising from a failure to file an annual report required by statute; Judge Ingram saying: "Either of the trustees might have avoided this liability by attending to the duty imposed upon him by the statute. He cannot charge any other trustees with the consequence of his own negligence. The statute imposes the duty on each, the liability attaches to each, and the policy of the law is to leave each one to the consequences of his own negligence, so as to insure stricter attention to the provisions of the statute on the part of each of the trustees, which might not be the case if such negligence could be divided between the whole."⁴

§ 806. If the officers of a corporation bind themselves for its benefit on the same obligation, they will be entitled to contribution from each other in regard to liability

Between
directors

¹ *Power v. O'Connor*, 19 W. R. 923.

³ 33 Barb., 354.

² Compare *Ashhurst v. Mason*, L. R. 20 Eq. 225; *Wilson v. Goodman*, 4 Hare, 54; *Lewin on Trusts*, 744, ed. 6.

⁴ 33 Barb. 354, 356. *Nickerson v. Wheeler*, 118 Mass. 295, is directly contrary to this decision. See §§ 764, 767.

bound on
the same
instru-
ment.

thereon¹; as where, for instance, directors become the makers and endorsers of a note to raise money for the corporation.¹

Between
directors
and other
officers.

§ 807. There would seem to be no reason to doubt that if directors through neglect of their duties are held to the corporation for damages resulting from a breach of trust committed by a subordinate officer or agent, they would be entitled to indemnification from him.

On the other hand, supposing that an executive or ministerial officer incurs liability from carrying out the orders of the board of directors, has he any rights over against them? It would seem so, if he acted innocently in the matter; but if he knew of the breach of trust intended by the board, then unquestionably he would have been an active cognizant party to it, and would have no right to contribution or indemnification from his fellow wrong-doers.

Right of
directors to
inspect
corporate
books.

§ 808. A director has a right at all times to inspect the books of the corporation; and if the board of directors, by resolution or by-law, attempt to exclude one of their number from examining the books, he may obtain a *mandamus*, directing the proper officer to allow him to examine them; and this holds true even when the other directors believe the one so excluded to be hostile to the corporation.²

De facto
directors.

§ 809. It has been held that trespass may be brought in the name of the corporation, by a board of *de facto* directors, who are in possession, against another board claiming to be the legal directors of the same corporation. And in such a suit, the defendants cannot defend by impeaching the title of the *de facto* directors; as this can only be done in some action in the nature of a *quo warranto*.³

¹ Slaymaker v. Gundacker, 10 S. & R. (Pa.) 75; Middleton v. McCartee, 2 Mackey (Dist. of Col.), 420. 247; but compare Rosenfeld v. Einstein, 46 N. J. L. 479.

² Mackey (Dist. of Col.), 420.

³ Atlantic, Tennessee, etc. R. R.

² People v. Throop, 12 Wend. 183.

Co. v. Johnston, 70 N. C. 348.

People v. Mott, 1 How. Pr. (N. Y.)

CHAPTER XVII.

LEGAL RELATIONS AMONG THE CREDITORS OF A CORPORATION.

Creditors who are also shareholders or officers, §§ 810, 811.	Mortgages covering property to be acquired. Contractors' liens, §§ 817, 818.
Other creditors, § 812.	
When the corporation is insolvent, § 813.	Mortgages of separate portions of the railroad. Rolling stock, § 819.
Capacities of receiver. Mortgage trustee, § 814.	Earnings, § 820.
Creditors having claims founded on the same instrument, § 815.	Appointment of receiver in foreclosure suit. Payment of current expenses, §§ 821, 822.
Provisions in railroad mortgages, § 816.	Receivers' orders, §§ 823, 824.
Reorganizations, 816 a.	Statutory liability of shareholders; priorities of creditors, §§ 825, 826.

§ 810. THE relationship of creditor may be occupied either by a person holding no other relationship towards the corporation, or by a shareholder, or by a director or other officer. If a person occupies towards the corporation a dual relationship, for the correct determination of his rights and liabilities in respect of the corporate enterprise, his two relationships must be kept distinct. Indeed, the two relationships between a corporation and a person who is at once shareholder and creditor, or director and creditor, are so distinguishable that a person holding such double relationship is, for many purposes, to be treated as two persons, and will not always be entitled to take advantage of being one person.¹

Creditors who are also shareholders or officers.

¹ Nor can a person who is merely an ordinary debtor to a corporation, buy up claims against it at a discount after it has passed into the hands of a receiver, or become evidently insolvent, and set them off at their face against his liability to the corporation. *Diven v. Phelps*, 34 Barb. 224; *Balch v. Wilson*, 25 Minn. 299; *Smith v. Mosby*, 9 Heisk. (Tenn.) 501; *Lanier v. Gayoso Savings Institution*, ib. 506.

§ 811. Thus, when a corporation is insolvent, a person occupying the two relationships of shareholder and creditor, who is indebted as shareholder for calls, may not offset against his indebtedness to the corporation the indebtedness of the latter to himself. • He must pay in his calls, and then he will rank as a creditor, receiving his due proportion of the corporate assets.¹ Again, a person occupying the dual relationship of director and creditor, may not, at least if the corporation is insolvent, use the advantages of his position as director to procure the payment of his claims as creditor in preference to the claims of other creditors. As a director, he must, in good faith, discharge his full duty towards all the persons interested in the corporate enterprise; and this forbids the favoring of any interest, as, for instance, his own.²

It is held, however, that a shareholder may make use of whatever advantages his position as shareholder may give him, to secure the payment of debts due him from the corporation, even to the exclusion of other creditors who are not shareholders.³ And at all events, the fact that a person occupies the status of shareholder or officer in a corporation, will not ordinarily prejudice his rights as a creditor, if he happens to be one. Thus, directors are not excluded from sharing as creditors, when they are such, *pro rata* with other creditors of the corporation.⁴

§ 812. The legal relations between creditors occupying no other relationship towards the corporation are simpler. One creditor may ordinarily sue the corporation at his will without regard to the effect which his suit may have on the payment of debts due other creditors.⁵ And credi-

¹ See § 729.

² See § 759.

³ *Whitwell v. Warner*, 20 Vt. 444. See §§ 710, 711. But, according to the better opinion, a corporation cannot make a valid insolvent assignment with preferences. See § 668. For the doctrine that corporate funds are trust funds for the payment of debts of the corporation, see §§ 654-659.

⁴ *Bristol Milling and M'fg Co. v. Probasco*, 64 Ind. 406.

⁵ In *Robinson v. Bank of Darien*, 18 Ga. 65, 108, it is said in substance, that where a judicial preference has been established by the superior legal diligence of any creditor, that preference will be observed as to legal assets, and execution creditors are entitled to preference; though perhaps, as to equitable assets where the judgment creditor must go into equity, the rule may be different, and creditors are equal and must share proportionately.

tors of a railroad company may, in order to protect themselves, combine into an association and buy in the road; provided there is no arrangement to prevent competition. Moreover, that the trustees making the sale, and two of the directors of the corporation were members of this association, was held not to render the sale void, but merely to give the corporation a right to redeem within a reasonable time, and before new equities had intervened.¹

§ 813. When, however, a corporation becomes insolvent, its assets constitute a fund for ratable distribution amongst its creditors; and no creditor can by suit or execution gain priority of payment over the rest.² This, at least, holds true after the corporate assets have passed into the hands of an assignee, or a receiver has been appointed.³ Under such circumstances it is competent for a creditor to restrain the payment to another of a greater proportion of his claim than the rest receive:⁴ except, of course, when the claim of the other is based on a lien acquired before the insolvency of the corporation. Subsequent lien-creditors, however, have a standing in court to contest the enforcement of prior incumbrances on the corporate property,⁵ unless the secu-

When the corporation is insolvent.

¹ *Kitchen v. St. Louis, etc. R'y Co.*, 69 Mo. 224.

² *Marr v. Bank of West Tennessee*, 4 Coldw. (Tenn.) 471.

³ *Clinkscales v. Pendleton M'f'g Co.*, 9 S. C. 318; *Hadley v. Freedman's Savings Co.*, 2 Tenn. Ch. 122. See *Dobson v. Simonton*, 86 N. C. 492; *Balch v. Wilson*, 25 Minn. 299; *Smith v. Mosby*, 9 Heisk. (Tenn.) 501; *Lanier v. Gayoso Savings Institution*, ib. 506.

The plaintiff took a fire policy in an insurance company on an agreement that the policy might be terminated at any time on notice by the insurers and return of the proper proportion of the premium, for the unexpired term. The company became insolvent and was dissolved. Its receiver notified all policy holders that their policies

were terminated. To this notice the plaintiff paid no heed, and subsequently suffered a loss. His claim was to participate in the assets of the company in respect of his loss; but the court held he could participate only on account of his unearned premium; and based their decision on the ground that after the dissolution of a corporation and the appointment of a receiver, a creditor could acquire no new rights against the corporation. *Dean & Son's Appeal*, 98 Pa. St. 101.

⁴ *Pfohl v. Simpson*, 74 N. Y. 137. See *People v. Security Life Ins. Co.*, 71 N. Y. 222.

⁵ *Commonwealth v. Smith*, 10 Allen, 448; see *Fox v. Seal*, 22 Wall. 424. Compare § 185.

city of the subsequent lien-creditors is in terms made subject to the prior incumbrance.¹ But a judgment creditor will never be entitled to dispute the validity of a prior mortgage merely on the ground that its execution was irregular, when the corporation has had the benefit of the mortgage and would itself be in no position to contest its validity.²

§ 814. When there is a receiver of the corporate assets, the various rights of creditors are enforceable by him; and he may contest the payment of debts arising from *ultra vires* or illegal transactions, and maintain actions to recover moneys paid on illegal or fraudulent claims to persons assuming to be creditors of the corporation.³ If, however, the receiver is delinquent in the discharge of his trust, an injured creditor will have a standing in court to enforce the proper distribution of the corporate assets.⁴

Mortgages or trust-deeds covering the property of corporations are usually made to a trustee for bondholders, who thereby becomes, in accordance with the terms of the mortgage or trust-

¹ *Bronson v. La Crosse, etc. R. R. Co.*, 2 Wall. 283; *Bundy v. Iron Co.*, 38 Ohio St. 300. See *Hasselman v. United States Mortgage Co.*, 97 Ind. 365. A decree of sale of a railroad, had in the foreclosure of a first mortgage thereon, recited that the sale "shall be subject to the liens established, or which may be established, by said court in this cause on references heretofore had and now pending, as prior and superior to the lien of the holder of bonds issued under the first mortgage, decreed to be foreclosed by former decree in said cause." These references were to a master to determine the priority of the lien of receiver's certificates and the like, and in the orders of reference, permission was given to the bondholders to oppose any claims before the master. The purchaser at the sale was held to have no standing in court, even on the ground that these liens

had been established by fraud practised on the master and the court, to re-litigate the liens expressly subject to which he bought and took title, the same recitals being in substance expressed in his deed; said purchaser having made no offer to surrender the property to be re-sold for the benefit of those concerned. *Swann v. Wright's Ex'r*, 110 U. S. 590.

² *Thomas v. Citizens' Horse R'y Co.*, 104 Ill. 462; *Taylor v. Agricultural, etc. Ass'n*, 68 Ala. 229; *Bundy v. Iron Co.*, 38 Ohio St. 300.

³ See *Whittlesey v. Delaney*, 73 N. Y. 571; also §§ 273, 542. The receiver of a corporation may avoid a chattel mortgage on its property, on the ground that it was not filed according to law. *Farmers' L. and T. Co. v. Minneapolis, etc. Works*, 35 Minn. 543.

⁴ See *Pfohl v. Simpson*, 74 N. Y. 137.

deed, the representative of the bondholders for the purposes of the trust.¹ "The trustee of a railroad mortgage," said Chief Justice Waite, giving the opinion of the Federal Supreme Court in *Shaw v. Railroad Co.*, "represents the bondholders in all legal proceedings carried on by him affecting his trust, to which they are not actual parties, and whatever binds him, if he acts in good faith, binds them."² Bondholders ordinarily are not necessary parties to a foreclosure suit brought by their trustee;³ and notice to the trustee in matters relating to his trust is notice to the bondholders.⁴

§ 815. When a number of creditors, as, for instance, bondholders, have claims against a corporation arising from the same transaction or series of transactions, and secured by the same security, their mutual relations, as well as their relations towards the corporation, will largely depend on the terms of their security. In such case, however, even in the absence of any special provision or agreement forbidding it, one creditor cannot proceed alone and enforce his rights against the corporation to the detriment of other creditors similarly situated. When persons have a common interest in a security, equity will not allow one of them to appropriate it exclusively to himself, or impair its worth to the others; for community of interest in-

Creditors having claims founded on the same instrument.

¹ Bondholders are affected with notice of the terms of the mortgage or trust-deed securing their bonds. See § 674.

² *Shaw v. Railroad Co.*, 100 U. S. 605, 611.

³ *Shaw v. Norfolk County R. R. Co.*, 5 Gray (Mass.), 162; *Williamson v. New Jersey Southern R. R. Co.*, 25 N. J. Eq. 13.

⁴ Actual notice to a mortgage trustee of an agreement to which property received by a railroad company is subject, is notice to bondholders. *Pierce v. Emery*, 32 N. H. 484. So is actual notice to trustee of a prior equitable mortgage. *Miller v. Rutland, etc. R. R. Co.*, 36 Vt. 452. But see Com-

missioners, etc. *v. Thayer*, 94 U. S. 631.

A mortgage trustee in possession cannot bind the bondholders personally for the payment of the expenses of the road. See *Chaffee v. Rutland R. R. Co.*, 53 Vt. 345. Compare *Sturgis v. Knapp*, 31 Vt. 1.

When a mortgage trustee is himself a judgment creditor, bondholders cannot object to his levying execution on property of the railroad company not covered by the mortgage. *Eldridge v. Smith*, 34 Vt. 384.

As to officers of the corporation acting as trustees for bondholders, see § 629, note.

volves mutual obligation. Thus, although one bondholder under a railroad mortgage may often use it to enforce the payment of his claim,¹ he cannot use it to obtain an advantage for himself over the other bondholders; he cannot use it to become the owner of the mortgaged premises at the lowest possible price, leaving unpaid the bonds of the other bondholders. His duty, if he uses the security, is to make it productive of the most obtainable for all interested in it; and if he seeks to make a profit at the expense of those whose rights in the security are the same as his own, he is unfaithful to the relation which he has assumed, and guilty of fraud.²

¹ When a trustee under a mortgage, on being applied to in pursuance of its terms, refuses to sue, the bondholders may themselves sue, making the trustee, the corporation, and the rest of the bondholders parties. *Hotel Co. v. Wade*, 97 U. S. 13. See *Galveston R. R. v. Cowdrey*, 11 Wall. 459; § 682. But see *Hackensack Water Co. v. DeKay*, 36 N. J. Eq. 548; and compare *New York Guaranty, etc. Co. v. Memphis Water Co.*, 107 U. S. 205. Unsecured creditors are not proper parties to a suit to foreclose a mortgage on the property of a corporation. *Herring v. N. Y., etc. R. R. Co.*, 105 N. Y. 340.

In a recent case in Maine, damage was occasioned by sparks from a locomotive, while the railroad was being operated by trustees under a mortgage, before foreclosure. An action was brought under a statute providing that, "when a building or other property is injured by fire communicated by a locomotive engine, the corporation using it is responsible for such injury." It was held that a corporation subsequently formed of the bondholders was not liable; nor were the bondholders liable themselves, as the trustees were operating the road on their

own responsibility and not as agents for the bondholders; and a statute protected the trustees. *Stratton v. European, etc. R'y*, 74 Me. 422. But see *S. C.*, 76 Me. 269.

² *Jackson v. Ludeling*, 21 Wall. 616. In this case, the managers and local officers of an embarrassed railroad company, holding a small portion of its bonds, had obtained a hasty order of sale and sold out the road, grossly disregarding the rights of the rest of the bondholders. At the suit of the injured bondholders the sale was set aside. Compare *Wabash, etc. Canal Co. v. Beers*, 2 Black, 448.

A bondholder under a mortgage will not be entitled on the foreclosure of the same to enforce a side agreement made by him with the corporation, by which he would obtain an inequitable advantage over the other bondholders. *Vose v. Bronson*, 6 Wall. 452.

When bonds in excess of the limit under a mortgage are sold to *bona fide* purchasers, and nothing appears in the bonds or in the mortgage by which the purchasers could have ascertained that the bonds which they purchased were unauthorized, such purchasers will be entitled to share *pro rata* with the other bondholders. *Stanton v. Ala-*

In another case, where a railroad mortgage of doubtful adequacy had been executed directly to all the bondholders by name, to secure specifically the sum due to each, it was held that no single bondholder, even though professing to act on behalf of all who might come in and contribute to the expenses of the suit, could proceed alone against the company, and obtain a sale of the property mortgaged. For, the sufficiency of the security being doubtful, all other creditors similarly situated should have had notice, in order to protect their interests; and even in equity, a suit on a written instrument should be brought in the name of all who are formal parties to it, and retain an interest therein.¹ And again, where a collusive and fraudulent sale of corporate property, procured by one set of creditors, had been set aside at the suit of other creditors, the creditors procuring the collusive sale were held not entitled to recover back money which they had paid to the holders of a prior mortgage at a time when the suit to set the sale aside was pending; nor were they entitled to be subrogated to the security of such mortgage.²

§ 816. The provisions contained in some trust deeds and mortgages for the benefit of bondholders go far towards organizing the bondholders into a body corporate to take the place and perform the functions of the original corporation upon the insolvency of the latter. Thus, in

Provisions
in railroad
mortgages.

bama, etc. R. R. Co., 2 Woods, 523. The decision of the court, however, seems, in this case, actually to have rested on the inability of the court to determine which were the bonds that had been issued in excess, the court saying that it did not follow that the highest numbers were such, as the bonds might all have been negotiated together, and the highest numbers sold first.

¹ *Railway Co. v. Orr*, 18 Wall. 471. See *Pennock v. Coe*, 23 How. 117.

² *Railroad Co. v. Soutter*, 13 Wall. 517. Compare *Drury v. Cross*, 7 Wall. 299; § 760. But trustees under a railroad mortgage containing covenants of warranty may buy up a prior

incumbrance to protect the property from a forced sale, and will be entitled to subrogation to the security as against the company, and to be reimbursed the amount paid by them with legal interest. *Memphis and L. R. R. Co. v. Dow*, 120 U. S. 287.

Where a majority of shareholders and creditors foreclose a railroad collusively, such shareholders are necessary parties to a bill to set the sale aside. *Ribon v. Railroad Cos.*, 16 Wall. 446. But bondholders under a mortgage are not ordinarily necessary parties to a foreclosure suit brought by the trustees under the mortgage. *Williamson v. New Jersey Southern R. Co.*, 25 N. J. Eq. 13, § 814.

the mortgage of a railroad it was covenanted and agreed by all the parties thereto, "that in case of any judicial foreclosure sale, . . . and the holders of a majority of the then outstanding bonds secured by this mortgage shall in writing request said trustees or their successors, they are authorized to purchase premises embraced herein for the use and benefit of the holders of the then outstanding bonds secured by this mortgage, and having so purchased said premises, the right and title thereto shall vest in said trustees, and no bondholder shall have any claim to the premises or the proceeds thereof, except for his *pro rata* share of the proceeds of the said purchased premises, as represented in a new company or corporation to be formed for the use and benefit of the holders of the bonds secured hereby, and the said trustees may take such lawful measures as deemed for the interest of said bondholders, to organize a new company or corporation for the benefit of the holders of the bonds secured by this mortgage. Said new company or corporation shall be organized upon such terms, conditions, and limitations, and in such a manner, as the holders of a majority of the said outstanding bonds secured by this mortgage shall in writing request or direct, and said trustees so purchasing shall thereupon re-convey the premises so purchased by them to said new company or corporation." A default having been made, and a foreclosure brought, the court held that this agreement inured equally to the benefit of all the bondholders, and that each held his interest subject to the controlling power therein given to the majority.¹

§ 816 a. Ordinarily, a majority of mortgage bondholders cannot by an agreement that the railroad company may issue a mortgage taking preference to theirs, affect the rights of a minority.² And neither can bond-

Re-organiza-
tions.

¹ Sage v. Central R. R. Co., 99 U. S. 334. See also Shaw v. Railroad Co., 100 U. S. 605.

² Poland v. Lamoille Valley R. R. Co., 52 Vt. 144. As to priorities of the holders of detached coupons over bondholders, see Sewall v. Brainerd, 38 Vt. 364; Miller v. Rutland, etc. R. R. Co., 40 Vt. 399.

A person who advances money to the corporation to take up coupons, under an undisclosed agreement that they are to be delivered to him uncanceled, but the coupon-holders having no reason to think they were not paid, but rather having every reason to suppose them simply paid and cancelled, cannot claim a lien under the mort-

holders or shareholders claim the benefits of a reorganization when they fail to comply with its terms.¹ In a case which not long ago came before the Supreme Court of the United States, the parliament of the Dominion of Canada had authorized a railroad corporation, existing under its authority, to enforce a settlement upon the mortgage creditors of the company, by which they were to receive other securities of the company in place of their mortgage bonds; and the settlement preserved the right of citizens of the United States, being bondholders, to participate in the reorganization on the same terms as Canadians and other British subjects. The settlement, assented to by more than three-fourths of the bondholders, having gone into effect, the court held that it was binding on non-assenting bondholders, citizens of the United States, who brought suit in a Federal court to recover on their bonds.² Giving the opinion of the court, Chief Justice Waite said: "Holders of bonds and other obligations issued by large corporations for sale in the market, and secured by mortgages to trustees or otherwise, have by fair implication certain contract relations with each other. . . . They are not corporations, and thus necessarily, in the absence of fraud or undue influence, bound by the will of the majority as to matters within the scope of the cor-

poration. *Cameron v. Tome*, 64 Md. 507.

¹ *Fidelity Ins. Co.'s Appeal*, 106 Pa. St. 144. When a statute provides that any shareholder may within six months come in and assent to a plan of re-organization (after a railroad foreclosure) and comply with its terms and thereby become entitled to share in the benefits, he gains no rights by an assent after the six months have expired; and equity cannot relieve him from the effect of his failure to perform this condition precedent. *Vatable v. New York, etc. R. R. Co.*, 96 N. Y. 49.

A provision in the Constitution of Arkansas, that "no private corporation shall issue stock or bonds except

for money or property actually received, or labor done; and all fictitious increase of stock or indebtedness shall be void," does not prevent the carrying out of an agreement between mortgage bondholders of an embarrassed railroad, whereby trustees are to buy the mortgaged property on foreclosure, and convey it to a new company to be organized by the bondholders, which should issue new mortgage bonds in lieu of the old bonds, and full paid up stock to the bondholders without any payment of money. *Memphis & L. R. R. Co. v. Dow*, 120 U. S. 287.

² *Canada Southern R. Co. v. Gebhard*, 109 U. S. 527.

porate powers, but they are interested in the administration of a trust which has been created for their common benefit. Ordinarily, their ultimate security depends in a large degree on the success of the work in which the corporation is engaged, and it is not uncommon for differences of opinion to exist as to what ought to be done for the promotion of their mutual interests. In the absence of statutory authority, or some provision in the instrument which establishes the trust, nothing can be done by a majority, however large, which will bind a minority without their consent.¹ Hence it seems to be eminently proper that where the legislative power exists some statutory provision should be made for binding the minority in a reasonable way by the will of the majority; and unless, as in the case in the states of the United States, the passage of laws impairing the obligation of contracts is forbidden, we see no reason why such provisions may not be made in respect to existing as well as prospective obligations. The nature of securities of this class is such that the right of legislative supervision for the good of all, unless restrained by some constitutional prohibition, seems almost necessarily to form one of their ingredients, and when insolvency is threatened, and the interests of the public, as well as creditors, are imperilled by the financial embarrassments of the corporation, a reasonable "scheme of arrangement" may in our opinion as well be legalized as an ordinary "composition in bankruptcy." In fact such "arrangement acts" are a species of bankrupt acts. Their object is to enable corporations created for the good of the public to relieve themselves from financial embarrassments by appropriating their property to the settlement and adjustment of their affairs, so that they may accomplish the purposes for which they were incorporated."²

§ 817. A mortgage by a corporation, as for instance a railroad company, when competently made, attaches to whatever of the property of the corporation it purports to cover, whether acquired or to be acquired; and the bondholders under such mortgage have ordinarily a lien on the property covered by the mort-

Mortgages
covering
property
to be ac-
quired.
Contract-
ors' liens.

¹ Same language used in *Gilfillan v. Union Canal Co.*, 109 U. S. 401, 403. ² *Canada Southern R. Co. v. Gebhard*, 109 U. S. 527, 534, etc.

gage prior in law as in time to any subsequently accruing rights of other creditor.¹ But if at the time of executing a railroad mortgage there exist statutes which give contractors a first lien on railroads for labor performed on them, a contractor by duly filing his lien in accordance with the statute will acquire as against the mortgagees and bondholders a lien prior in effect, although the mortgage may have been recorded first.²

§ 818. When a railroad company mortgages its road, "built and to be built," although at the time when the mortgage is executed but a portion of the road is built, the mortgage attaches to the unbuilt portions of the road as they are built, and takes precedence of the claims of the contractors³ (unless there are statutes giving contractors a prior lien), and judgment creditors, as well as bondholders under a subsequent mortgage covering the portions of the road which were unbuilt when the first mortgage was given.⁴ A mortgage, however, intended to cover after acquired property attaches to such property in the condition in which it comes into the possession of the company.⁵ Consequently, if property, when acquired by the company, is already subject to mortgages or other liens, the general mortgage, though prior in time, does not displace them; and if

¹ See, *e. g.*, *Loudenslager v. Benton*, 4 Phila. 382; *Covey v. Pittsburgh, Ft. W., etc. R. R. Co.*, 3 Phila. 173; *Hamlin v. Jerrard*, 72 Me. 62; *Hamlin v. European, etc. R. R. Co.*, 72 Me. 83. As to what property a railroad mortgage covers, see § 676.

So when a corporation accepts bonds of a state or county issued by virtue of a law which declares that they shall be a first lien on its property, such lien will arise on the acceptance of them by the corporation, and a purchaser of the road or of its bonds issued under a subsequent mortgage, is bound to take notice of the act; and the lien of the county under the act is enforceable against the funds in the hands of a receiver, appointed in a foreclosure suit of the subsequent mortgage, and

against the purchaser of the road. *Ketchum v. St. Louis*, 101 U. S. 306; *Wilson v. Boyce*, 92 U. S. 320.

² *Brooks v. R. R. Co.*, 101 U. S. 443; *Meyer v. Hornby*, *ib.* 728. See *Fox v. Seal*, 22 Wall. 424. Compare *Woods v. Pittsburgh, Cin. and St. L. Ry. Co.*, 99 Pa. St. 101.

³ *Dunham v. Railway Co.*, 1 Wall. 254.

⁴ *Pennock v. Coe*, 23 How. 117; *Galveston R. R. Co. v. Cowdrey*, 11 Wall. 459; *First Nat. Bk. v. Anderson*, 75 Va. 250. See *Buck v. Seymour*, 46 Conn. 156; *Branch v. Atlantic, etc. R. R. Co.*, 3 Woods, 481.

⁵ *Botsford v. New Haven, etc. R. R. Co.*, 41 Conn. 454; *Williamson v. New Jersey Southern R. R. Co.*, 29 N. J. Eq. 311.

a railroad company when acquiring property gives back a purchase-money mortgage, the giving of the mortgage and the purchase of the property constituting one transaction, the purchase-money mortgage will take precedence, in respect of the property purchased, over every lien, or mortgage, or judgment covering the entire property of the company.¹ Thus, a railroad company mortgaged its present and future property, and then entered into a written agreement with a car company, by which the former hired certain cars at a rent payable monthly, reserving the right to purchase them at their original cost, the car company retaining the right to rescind the agreement if the railroad company failed to pay the interest on its bonds. While this contract was in force, the mortgagee filed a foreclosure bill, and a receiver was appointed in the foreclosure suit, who took charge of the road, and used the cars above mentioned in operating it. The court held that the contract between the railroad company and the car company was binding, and that the latter was entitled to the possession of the cars, and to compensation for their use by the receiver, payable out of the fund to the credit of the foreclosure suit.²

§ 819. A railroad company may give distinct mortgages covering separate portions of its road, and in such case one mortgagee has no rights over the portion of the road covered by the other mortgage, and is not even a necessary party to a suit to foreclose it.³ In regard to rolling stock, however, it may be different, and it has been held that in the absence of any specific apportionment between the several divisions of the road covered by separate mortgages, the terms of which are sufficiently broad

Mortgages
of separate
portions of
railroad.
Rolling
stock.

¹ *United States v. New Orleans Railroad*, 12 Wall. 362, where it was held that a failure to register the purchase-money mortgage made no difference; but the court said that if the purchased property had been rails to be attached to the road, the case might have been decided differently. See also *Botsford v. New Haven, M. and W. R. R. Co.*,

41 Conn. 454; *Hand v. Savannah*, etc. R. R. Co., 12 S. C. 314, 364; *Hall v. Mobile, etc. Ry. Co.*, 58 Ala. 10.

² *Myer v. Car Company*, 102 U. S. 1.

³ *Bronson v. Railroad Co.*, 2 Black, 524. Compare *Chicago, Danville, etc. Ry. Co. v. Lowenthal*, 93 Ill. 433.

to include rolling stock, such mortgages attach to all the rolling stock in the order of their priority.¹

§ 820. Where, according to the terms of a railroad mortgage, the company is to hold possession of the road and receive the earnings, until the mortgagees take possession, or the proper judicial authority interposes, such possession gives the company a right to the whole fund of the earnings and subjects them to its control. The earnings, consequently, remain as liable to the creditors of the company as if the mortgage did not exist.² Thus, a corporation mortgaged its property, rents, issues, and profits, giving to the trustee the right to enter and take possession and collect the rents and issues. Default having been made, the trustee filed a bill to subject the moneys of the company on hand to the claims of the mortgage. A judgment creditor whose execution had been returned *nulla bona*, also filed a bill to obtain satisfaction of his judgment from the same moneys; and it was held that, since the trustee had not taken possession, his claim to the moneys should be postponed to that of the judgment creditor.³

§ 821. When pending the foreclosure of a railroad mortgage, the trustees or the bondholders procure the appointment of a receiver of the corporate property, it is competent for the court to add to the order appointing the receiver such terms and conditions in regard to the payment of the current expenses of the road incurred prior to his appointment,⁴ as well as in

Appointment of receiver in foreclosure suit. Payment of current expenses.

¹ *Minnesota Co. v. St. Paul Co.*, 6 Wall. 742. See § 676.

Where a receiver in Kentucky is appointed under a mortgage including rolling stock, an Ohio court will enforce his claim on a part of such rolling stock, temporarily in Ohio, as against the attachment of an unsecured Kentucky creditor. *Bank v. McLeod*, 38 Ohio St. 174.

² *Gilman v. Illinois, etc. Tel. Co.*, 91 U. S. 603. A decree, silent as to the profits and possession of the road from the date of the decree until the sale thereby ordered, does not affect

rights to such profits and possession during that period. *Ib.* *De Graff v. Thompson*, 24 Minn. 452. Compare *Coe v. Peacock*, 14 O. St. 187; *Coe v. Columbus, etc. R. R. Co.*, 10 O. St. 372; *Coe v. Knox County Bank*, 10 O. St. 412. *Contra*, *Dunham v. Isett*, 15 Iowa, 284; *Jessup v. Bridge*, 11 Iowa, 572.

³ *American Bridge Co. v. Heidelberg*, 94 U. S. 798. Compare *King v. Housatonic R. R. Co.*, 45 Conn. 226.

⁴ *Metropolitan Trust Co. v. Tondawanda, etc. R. R. Co.*, 103 N. Y.

regard to expenses incurred during the time of the receivership, as may seem to the court just or expedient in view of the circumstances of the case.

§ 822. Here the leading authority is *Fosdick v. Schall*,¹ where Chief Justice Waite said, giving the opinion of the Federal Supreme Court: "We have no doubt that when a court of chancery is asked by railroad mortgagees to appoint a receiver of the railroad property, pending proceedings for foreclosure, the court, in the exercise of a sound judicial discretion, may, as a condition of issuing the necessary order, impose such terms with reference to the payment from the income during the receivership of outstanding debts for labor, supplies, equipment, or permanent improvement of the mortgaged property as may, under the circumstances of the case, appear to be reasonable. Railroad mortgages and the rights of railroad mortgagees are comparatively new in the history of judicial proceedings. They are peculiar in their character and affect peculiar interests. The amounts involved are generally large, and the rights of parties oftentimes complicated and conflicting. It rarely happens that a foreclosure is carried through to the end without some concessions by some parties from their strict legal rights, in order to receive advantages that could not otherwise be attained, and which it is supposed will operate to the general good of all who are interested. This results almost as a matter of necessity from the peculiar circumstances which surround such litigation.

"The business of all railroad companies is done to a larger or less extent on credit. The credit is longer or shorter as the necessities of the case require; and when companies become pecuniarily embarrassed it frequently happens that debts for labor, equipment, and improvements are permitted to accumulate, in order that bonded interest may be paid and a disastrous foreclosure postponed, or altogether avoided. In this way the daily and monthly earnings, which ordinarily should go to pay the daily and monthly expenses, are kept from those to whom in equity they belong, and used to pay the mortgage debt.

245, is adverse to this; but the weight of authority favors the full proposition stated in the text. ¹ 99 U. S. 235.

The income out of which the mortgagee is to be paid, is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, proper equipment and useful improvements. Every railroad mortgagee impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim on the income. If, for the convenience of the moment, something is taken from what may not improperly be called the current debt fund, and put into that which belongs to the mortgage creditors, it certainly is not inequitable for the court, when asked by the mortgagees to take possession of the future income, and hold it for their benefit, to require as a condition of such an order, that what is due from the earnings to the current debt shall be paid by the court from the future current receipts before anything derived from that source goes to the mortgagees.¹ In this way the court will only do what, if a receiver should not be appointed, the company ought itself to do. For even though the mortgage may in terms give a lien upon the profits and income, until possession of the mortgaged premises is actually taken, or something equivalent done, the whole earnings belong to the company and are subject to its control.²

¹ "So far as current expense creditors are concerned, the court should use the income of the receivership in the way the company would have been bound in equity and good conscience to use it if no change in the possession had been made If current earnings are used for the benefit of mortgage creditors before current expenses are paid, the mortgage security is chargeable in equity with the restoration of the fund which has been thus improperly applied to their use." *Burnham v. Bowen*, 111 U. S. 776, 782, 783.

² Compare *King v. Housatonic R. R. Co.*, 45 Conn. 226. The earnings of a road in the hands of a receiver are chargeable with the value of goods

lost in transport, and with damages done to property during his management, in preference to the claims of bondholders, under an existing mortgage. *Cowdrey v. Galveston, etc. R. R. Co.*, 93 U. S. 352. Earnings of the road in hands of a receiver are chargeable with injuries to a person sustained while the road is in the receiver's hands. *Mobile and O. R. R. Co. v. Davis*, 62 Miss. 271.

The assignee of a claim which is entitled, as against the claims of bondholders, to be paid from earnings in the receivers' hands, has all the rights of his assignor. *Union Trust Co. v. Walker*, 107 U. S. 596; *Burnham v. Bowen*, 111 U. S. 776. If the claim as against the funds of the receiver-

"The mortgagee has his strict rights, which he may enforce in the ordinary way. If he asks no favors, he need grant none. But if he calls upon a court of chancery to put forth its extraordinary powers and grant him purely equitable relief, he may with propriety be required to submit to the operation of a rule which always applies in such cases, and do equity in order to get equity. The appointment of a receiver is not a matter of strict right. . . .

"We think, also, that if no such order is made when the receiver is appointed, and it appears in the progress of the cause that bonded interest has been paid, additional equipment provided, or lasting and valuable improvements made out of earnings which ought, in equity, to have been employed to keep down debts for labor, supplies, and the like, it is within the powers of the court to use the income of the receivership to discharge obligations, which, but for the diversion of funds, would have been paid in the ordinary course of business. This, not because the creditors to whom such debts are due have, in law, a lien upon the mortgaged property or the income, but because, in a sense, the officers of the company are trustees of the earnings for the benefit of the different classes of creditors and the stockholders; and if they give to one class of creditors that which properly belongs to another, the court may, upon an adjustment of the accounts, so use the income which comes into its hands, as, if practicable, to restore the parties to their original equitable rights. While, ordinarily, this power is confined to the appropriation of the income of the receivership and the proceeds of moneyed assets that have been taken from the company, cases may arise where equity will require the use of the proceeds of the sale of the mortgaged property in the same way. . . . The power rests upon the fact, that in the administration of the affairs of the company the mortgage creditors have got possession of that which, in equity, belonged to the whole, or a part of the general creditors."¹

ship, is evidenced by commercial paper, it is no waiver of the claim to renew the paper. *Ib.*

¹ *Fosdick v. Schall*, 99 U. S. 235, 251, etc. Affirmed and followed in

Fosdick v. Car Co., *ib.* 256; *Huidekoper v. Locomotive Works*, *ib.* 258; *Union Trust Co. v. Souther*, 107 U. S. 591; *Burnham v. Bowen*, 111 U. S. 776; *Williamson v. Washington*

§ 823. In accordance with the principles indicated in the foregoing opinion, it is held that a court of equity, which has appointed managing receivers of such property as a railroad, when taken under its charge as a trust fund for the payment of incumbrances, has power to authorize the receivers to raise money necessary for the preservation and management of the property, and make such money chargeable as a first lien thereon.¹ This power is regarded as part of the jurisdiction which is exercised by a court of equity in carrying out its duty to protect and preserve trust funds in its hands. It should be exercised with caution, and if possible with the consent or acquiescence of the parties interested in the fund.²

Receivers' orders.

§ 824. In one of its latest decisions of importance on this subject the Federal Supreme Court held that a court of equity could create claims, through a receiver appointed by it on the foreclosure of a railroad mortgage; prior to the lien of the mortgage; and could decree that the receiver should pay the

City, etc. R. R. Co., 33 Gratt. (Va.) 624; Addison v. Lewis, 75 Va. 701; Atkins v. Petersburg R. R. Co., 3 Hughes, 307; Douglass v. Cline, 12 Bush (Ky.), 608.

See also Hale v. Frost, 99 U. S. 389; Meyer v. Johnston, 53 Ala. 237; Union Trust Co. v. Walker, 107 U. S. 596; Farmers' Loan, etc. Co. v. Missouri, etc. R'y Co., 21 Fed. Rep. 264.

Compare Newport, etc. Bridge Co. v. Douglass, 12 Bush (Ky.), 673. The cases of Metropolitan Trust Co. v. Tonawanda Valley, etc. R. R. Co., 103 N. Y. 245, and Duncan v. Mobile, etc. R. R. Co., 2 Woods, 542, seem not to accord with the above decisions.

¹ Miltenberger v. Logansport Railway, 106 U. S. 286; Wallace v. Loomis, 97 U. S. 146; Langdon v. Railroad Co., 53 Vt. 228; see Same v. Same, 54 Vt. 593.

² Wallace v. Loomis, *supra*. While

a railroad was in the hands of, a receiver appointed in a foreclosure suit, the court authorized him to borrow money and issue certificates, to be a lien prior to the mortgage debt, and to part with them at not less than ninety cents on a dollar. The receiver borrowed money by hypothecating some of the certificates. Held, that the hypothecated certificates were not liens to the extent of their face; but that a decree was proper allowing the repayment of the moneys loaned on certificates issued at ninety cents on the dollar and making such certificates a lien. Swann v. Clark, 110 U. S. 602.

For ordinary debts which were not allowed prior payment (over bondholders) out of funds in hands of receiver, see Addison v. Lewis, 75 Va. 701. Such are debts incurred in the construction (not maintenance) of the road. Boston, etc. Co. v. Chesapeake and O. R. R. Co., 76 Va. 180.

operating expenses of the road for ninety days preceding his appointment, and also certain sums of money, amounting to ten thousand dollars, due other and connecting lines for materials and repairs and for ticket and freight balances, a part of which last indebtedness was incurred more than ninety days prior to the appointment of the receiver. The above claims were ordered to be paid out of the net proceeds of the sale, before paying the mortgage bonds.¹ Giving the opinion of the court, Judge Blatchford said: "It cannot be affirmed that no items which accrued before the appointment of a receiver can be allowed in any case. Many circumstances may exist which make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay pre-existing debts of certain classes, out of the earnings of the receivership, or even the *corpus* of the property, under the order of the court, with a priority of lien. Yet the discretion to do so should be exercised with very great care. The payment of such debts stands *prima facie* on a different basis from the payment of claims arising under the receivership, while it may be brought within the principle of the latter by special circumstances. It is easy to see that the payment of unpaid debts for operating expenses, accrued within ninety days, due by a railroad company, suddenly deprived of the control of its property, due to the operatives in its employ, whose cessation from work simultaneously is to be deprecated, in the interests both of the property and of the public, and the payment of limited amounts due to other and connecting lines of road for materials and repairs and for unpaid ticket and freight balances, the outcome of indispensable business relations, where a stoppage of the continuance of such business relations would be a probable result, in case of non-payment, the general consequences involving largely, also, the interests and accommodation of travel and traffic, may well place such payments in the category of payments to preserve the mortgaged property in a large sense, by maintaining the good-will and integrity of the enterprise, and entitle them to be made a first lien."²

¹ *Miltenberger v. Logansport Railway*, 106 U. S. 286.

² *Miltenberger v. Logansport Railway*, 106 U. S. 286, 311. See also

§ 825. In respect of the statutory individual liability of shareholders it is said that "a creditor who moves first and proceeds so far as to establish his right to seize the property of a stockholder, or to bring his suit, obtains a priority of right in the fund which the statute has in effect set apart for the payment of his debt. By such proceedings, and the institution of a suit within the period fixed by the statute, he acquires a right to recover against the stockholder to the amount of his stock, with which no creditor subsequently moving can rightfully interfere, and any payment made to such subsequently moving creditor by such stockholder must be regarded as a payment in his own wrong."¹ The case, however, in which these remarks occur, arose under the construction of a particular statute, and consequently is to be applied with caution.²

Statutory liability of shareholders. Priorities of creditors.

§ 826. When an action has been instituted by part of the creditors of an insolvent corporation for the benefit of all the creditors, against the shareholders to enforce the (limited) statutory liability of the latter, no creditor can acquire priority, or

Union Trust Co. v. Illinois Midland Ry. Co., 117 U. S. 434; Williamson v. Washington City, etc. R. R. Co., 33 Gratt. (Va.) 624; Poland v. Lam-
oille Valley R. R. Co., 52 Vt. 144. Compare Hand v. Savannah, etc. R. R. Co., 17 S. C. 219, 266; *Ex parte* Benson & Co., 18 S. C. 38; *Ex parte* Carolina Nat. Bk., ib. 289; Denniston v. Chicago, Alton, etc. R. R. Co., 4 Biss. 414. When bondholders suffer certain persons to act as receivers, and issue negotiable certificates, which come into the hands of *bona fide* holders for value, the bondholders cannot set up that the receivers were improperly appointed. Langdon v. Vermont, etc. R. R. Co., 53 Vt. 228; see Humphreys v. Allen, 101 Ill. 490. But it has been held that receiver's certificates payable to a given person "or bearer" are not negotiable, and when

issued without benefit or consideration to the receivership, so that the payee could not have recovered on them against funds in the hands of the receiver, cannot be recovered on against such funds by a *bona fide* holder for value. Turner v. Peoria and S. R. R. Co., 95 Ill. 134.

¹ Cole v. Butler, 43 Me. 401, 404, per May, J., approved in Ingalls v. Cole, 47 Me. 530, 541. Accord, Jones v. Wiltberger, 42 Ga. 575; Thebus v. Smiley, 110 Ill. 316.

² *Semble*, contra, Pfohl v. Simpson, 74 N. Y. 137; Donnelly v. Mulhall, 12 Mo. App. 139. In Illinois a creditor obtains a prior lien only through a final judgment in his favor. Chicago v. Hall, 103 Ill. 342; but see Thebus v. Smiley, 110 Ill. 316. Compare State Savings Ass'n v. Kellogg, 63 Mo. 540.

institute a separate suit for the enforcement of such liability on his own behalf.¹

¹ Wright v. McCormack, 17 Ohio 520. Also, specially, §§ 725, 726, St. 86; Pfohl v. Simpson, 74 N. Y. 704-706.

137. See Pollard v. Bailey, 20 Wall.

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